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Achieving the United Nations Sustainable Development Goals

An enabling role for accounting research

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Abstract

Purpose – The purpose of this paper is to establish and advance the role of academic accounting in the pursuit of the United Nations Sustainable Development Goals (SDGs), which are regarded as the most salient point of departure for understanding and achieving environmental and human development ambitions up to (and no doubt beyond) the year 2030.

Design/methodology/approach – This paper provides a synthesis of interdisciplinary perspectives on sustainable development and integration of this with the accounting for sustainability literature. In addition, potential accounting research contributions are proposed so as to support the development of new research avenues.

Findings – Existing research in accounting that is relevant to individual SDGs serves as an initial link between them and the accounting discipline. At the same time, the SDGs focus highlights new sites for empirical work (including interdisciplinary investigations) as well as inviting innovation in accounting theoretical frameworks. Moreover, the SDGs provide a context for (re)invigorating accounting’s contribution to sustainable development debates.

Originality/value – This is the first paper to explore the roles academic accounting can play in furthering achievement of the SDGs through enhanced understanding, critiquing and advancing of accounting policy, practice and theorizing. It is also the first paper to propose a research agenda in this area.

Keywords Social and environmental accounting, Accounting, Sustainable Development Goals, Accounting and sustainable development, Accounting for sustainability

Paper type Research paper

1. Introduction

Research into the roles of accounting in furthering sustainable development has expanded, and become more sophisticated, over the three decades since the concept of sustainable development was proposed by the seminal Brundtland Report (United Nations World Commission on Environment and Development (UNWCED), 1987) as being a guiding principle bridging environmental and human development concerns (Bebbington and Larrinaga, 2014; Bebbington et al., 2014).

In the most recent iteration of the global sustainable development agenda, the United Nations’ (UN) Transforming Our World: The 2030 Agenda for Sustainable Development (UN, 2015) adopted 17 Sustainable Development Goals (SDGs) that are intended to “stimulate action over the next 15 years in areas of critical importance for humanity and the planet” (p. 3). These SDGs are increasingly being referred to in policy circles simply as “The Global Goals”. While being intergovernmental commitments, the SDGs have rapidly gained traction and salience among a broad range of actors beyond the 193 UN member states who unanimously endorsed them, such as public policy bodies, NGOs and many public sector and private sector organizations (including many businesses and professional bodies). As evidence later in this paper demonstrates, elements of the accounting profession are among actors who have enthusiastically embraced the SDGs, seeing a pivotal role for accountants and accounting in supporting their realization.
In the academic world, SDG-related research has begun to emerge in several disciplines, including business and management (Annan-Diab and Molinari, 2017; Schaltegger et al., 2017; Storey et al., 2017). Some of this research identifies and develops the energizing effects of committing to an SDG framework in guiding organizational policy and action. However, the SDGs and their potential and saliency have only just started to make an appearance in the accounting literature (see Bebbington et al., 2017).

In this paper, we argue that accounting academics can and should play a substantive role in helping embed policy and action at an organizational level in a way that contributes toward achievement of the SDGs. We therefore believe that there is a need to raise awareness of the SDGs among accounting academics to help in the initiation, scoping and development of high-quality research projects in this area. Equally, accounting scholarship has much to bring to the pursuit of the SDGs, a point that will be further developed in the latter sections of this paper.

While insights from the academic accounting literature are of relevance to individual SDGs, adoption of the SDG framework provides both an opportunity and need for research in this area to advance, refocus and become more impactful. In this context, this paper aims to establish and advance the role of academic accounting in pursuit of the SDGs, the most salient point of departure for understanding and achieving environmental and human development ambitions up to (and no doubt beyond) 2030. We show (through illustrative examples) how SDG-related accounting research can build on existing areas of research into accounting for sustainability and suggest some broad avenues for SDG-related accounting research.

In addressing its aims, this paper:

(1) Identifies the history, context and significance of the SDGs and thereby renews and deepens the knowledge and understanding within the academic accounting community about sustainable development.

(2) Explains the manner in which the SDGs have gained saliency among stakeholders in the accounting profession, including large professional bodies and large firms.

(3) Builds on illustrative examples from existing social, environmental and sustainable development accounting scholarship and practice in order to propose new avenues for evolution of accounting research. Indeed, it is our contention that the SDGs provide the impetus for accounting research into sustainable development to enter a new phase, both in terms of the design and execution of research as well as the intellectual underpinnings of the field.

To achieve these objectives, the paper is structured as follows: the next section explains the source of the SDGs, outlines the Goals themselves and discusses their importance in global sustainable development governance. In the subsequent section, the focus shifts to accounting practice and research, including explaining (and interrogating) the accounting profession’s engagement with the SDGs. This section also analyzes how existing academic literature that focuses on sustainable development might be relevant to the SDGs. The following section extends this analysis to suggest an agenda for accounting research that focuses on the SDGs directly by; drawing out accounting’s role in regimes of measurement associated with the Goals; introducing new and emerging research foci that might emerge from a SDG framing; and providing potential novel conceptual challenges that emerge in this context. This section is not an exhaustive listing of all possible new avenues for research. Rather, our aim is to suggest prompts both to open out existing scholarship of the many possible roles accounting could play in furthering organizational-level contributions to achievement of the SDGs, and to spark points for other ideas where interdisciplinary work involving accounting will be of value. The penultimate section outlines some
2. Introducing the SDGs
To provide context within which accounting academics can develop research projects that contribute toward achievement of the SDGs, this section explores key UN initiatives in the sustainable development arena (including the SDGs), and explains how the UN develops and implements such initiatives.

2.1 Key UN sustainable development initiatives preceding the SDGs
Founded in 1945 at the end of the Second World War, the UN currently comprises 193 countries. This makes it an organization with a unique span of influence. It provides a forum for member countries to express their views on the nature of the challenges facing the world and is a “mechanism for governments to find areas of agreement and solve problems together [addressing issues such as] peace and security, climate change, sustainable development, human rights, disarmament, terrorism, humanitarian and health emergencies, gender equality, governance, food production, and more” (www.un.org/en/sections/about-un/overview/index.html, accessed June 28, 2017). As such, the UN has the formal authority, as well as a long and substantive track record, in developing leadership positions and specific initiatives that aim to create the conditions for equitable and environmentally sustainable forms of development. These initiatives include a series of conferences linking environment and development (such as Stockholm in 1972; Rio in 1992; Johannesburg in 2002 and Rio+20 in 2012) and seminal documents such as the Brundtland Report (UNWCED, 1987). Sustainable development has emerged as an overarching organizing principle of this stream of work (see Bebbington (2001) who traces the history and relevance of these initiatives for accounting).

All of these conferences, and the international agreements, working groups, publications, goal setting and associated activities, have had ramifications: primarily for national governments, but also for other global institutions (e.g. the OECD, the World Bank and the International Monetary Fund). At the same time, these processes and initiatives also affect organizations, as the ramifications that emerge from global-level processes translate through to organizational-level impacts and through businesses engaging as part of the solutions to the problems identified. This is intentional as the UN bodies realize that action arises in particular physical locations/industry settings/organizations and hence cascades of initiatives from global to local layers is to be expected. Additionally, given the nature of the issues considered, entities other than governments are likely to wish to be (and indeed need to be) involved in implementation of global visions. The manner in which this linking arises is specific to each issue area. To provide a taste of how this has emerged in the past, the links from global concern for biodiversity to organizational and accounting salience are explained below.

In the area of biodiversity, high-level global commitments have crystallized into concrete requirements that affect organizations (and stimulate accounting action). The Stockholm Conference in 1972 led to the creation of the United Nations Environment Programme (UNEP) and provided the framework for addressing environmental concerns in the context of human development, and for development concerns to be cognizant of environmental concerns (Nelson, 2007). UNEP has the ability to lead international treaty processes (e.g. it was at the heart of the Montreal Protocol) and was the lead organization for the Convention on Biological Diversity (signed at the Rio Earth Summit in 1992 and focusing on advancing global co-ordination of the protection of biodiversity).
As part of this process, there are a series of targets for biodiversity (the Aichi Targets) that shape activities across many domains (see also Bebbington et al., 2015). Aichi Target 7 has a direct impact upon organizations, stating that “by 2020 areas under agriculture, aquaculture and forestry [should be] managed sustainably, ensuring conservation of biodiversity.” These are sectors where the actions of organizations will be impactful and have led (amongst other things) to the Global Partnership for Business and Biodiversity (www.cbd.int/business/gp.shtml, accessed June 28, 2017) which seeks ways for organizations to contribute to broader biodiversity goals. In addition, a number of tools have been developed that are used to provide information on biodiversity in a way that seeks to support sustainable production and consumption (itself a major theme in sustainable development initiatives in the UN). Perhaps the most recognizable tools using accounting and audit methodologies are in the area of product certification (see e.g. Moore, 2004). The time elapsed from the creation of an international framework and the use of (accounting) tools within organizations can be longer or shorter than this for different initiatives, but this example demonstrates that supranational process can and do cascade to individual organizations and hence involve accounting and accountability routines.

At a broader level, the SDGs themselves are an example of policies cascading from earlier policy initiatives – in this case, the Millennium Development Goals (MDGs). The MDGs were originally developed by the OCED in 1996 as part of their strategy paper for the twenty-first century. They were then taken forward by the UN. After an “iterated distillation, extracted from a wide array of global processes, with many actions involved over several years” (McArthur, 2014, p. 6, see also Scheyvens et al., 2016), the MDGs were agreed by Heads of State at the Millennium Summit in 2000. They were the “world’s first explicit development partnership framework between developed and developing countries” (McArthur, 2014, p. 20). The eight MDGs sought to: eradicate extreme poverty and hunger; achieve universal primary education; promote gender equality and empower women; reduce child mortality; improve maternal health; combat HIV/AIDS, malaria and other diseases; ensure environmental sustainability; and encourage global partnerships for development (www.un.org/millenniumgoals/, accessed June 28, 2017).

As will be apparent in the ensuing discussion about the SDGs, one defining difference between SDGs and MDGs is the opening up of MDG 7 into more detailed elements (namely, water, energy, climate change, oceans and terrestrial ecosystems), reflecting the functioning of the biosphere and its contribution to human development. Since the MDGs were developed, knowledge about ecosystem integrity has highlighted that the stability of ecosystems has deteriorated such that there may be “large-scale, abrupt, and potentially irreversible changes” on the horizon (Griggs et al., 2014, p. 49, see also Scheyvens et al., 2016). Griggs et al. (2014, p. 49) further argue that without “economic, technological, and societal transformation […] the potential for large-scale humanitarian crises is significant and could undermine any gains made by meeting the MDGs, necessitating a fundamental re-evaluation of the relationship between people and planet.” These concerns indicate how the SDGs can be linked back to the core motivation of the 1972 Stockholm Conference: developing a framework that can integrate human development and ecological integrity. The context within which such a purpose is pursued, however, has become more pressing.

2.2 The SDGs
To address their aims of “end[ing] poverty and hunger […] protect[ing] the plant […][and] ensur[ing] that all human beings can enjoy prosperous and fulfilling lives” (UN, 2015, p. 3), the SDGs comprise 17 goals (see Table I) relating to social, ecological and economic outcomes. They “serve as guideposts for a difficult transition to sustainable development” (Le Blanc, 2015, p. 176). All 193 UN Members States have committed to seeking to achieve the SDGs by 2030 (United Nations, 2016).
Programs of action (many of which are continuations of longstanding streams of work) underpin the SDGs, as does a measurement and performance framework consisting of 169 targets and 232 indicators in total (for details and explanations of the 169 targets, along with the context for each of the Goals, click on each individual Goal at: www.un.org/sustainabledevelopment/sustainable-development-goals/, accessed June 28, 2017. Details on the 232 SDG indicators can be found at: https://unstats.un.org/sdgs/indicators/indicators-list/ accessed October 2, 2017). As a result, the SDGs “have the potential to become the guiding vision for governmental, corporate and civil society action for a shared and lasting prosperity” (Hajer et al., 2015, p. 1657) and have been described as “the next era of human development that is transformational” (Caprani, 2016, p. 102).

<table>
<thead>
<tr>
<th>Goal number</th>
<th>Outline description</th>
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<tbody>
<tr>
<td>1</td>
<td>No poverty End poverty in all its forms everywhere</td>
</tr>
<tr>
<td>2</td>
<td>Zero hunger End hunger, achieve food security and improved nutrition and promote sustainable agriculture</td>
</tr>
<tr>
<td>3</td>
<td>Good health and well-being Ensure healthy lives and promote well-being for all at all ages</td>
</tr>
<tr>
<td>4</td>
<td>Quality education Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all</td>
</tr>
<tr>
<td>5</td>
<td>Gender equality Achieve gender equality and empower all women and girls</td>
</tr>
<tr>
<td>6</td>
<td>Clean water and sanitation Ensure availability and sustainable management of water and sanitation for all</td>
</tr>
<tr>
<td>7</td>
<td>Affordable and clean energy Ensure access to affordable, reliable, sustainable and modern energy for all</td>
</tr>
<tr>
<td>8</td>
<td>Decent work and economic growth Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all</td>
</tr>
<tr>
<td>9</td>
<td>Industry, innovation and infrastructure Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation</td>
</tr>
<tr>
<td>10</td>
<td>Reduced inequalities Reduce income inequality within and among countries</td>
</tr>
<tr>
<td>11</td>
<td>Sustainable cities and communities Make cities and human settlements inclusive, safe, resilient and sustainable</td>
</tr>
<tr>
<td>12</td>
<td>Responsible consumption and production Ensure sustainable consumption and production patterns</td>
</tr>
<tr>
<td>13</td>
<td>Climate action Take urgent action to combat climate change and its impacts by regulating emissions and promoting developments in renewable energy</td>
</tr>
<tr>
<td>14</td>
<td>Life below water Conserve and sustainably use the oceans, seas and marine resources for sustainable development</td>
</tr>
<tr>
<td>15</td>
<td>Life on land Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss</td>
</tr>
<tr>
<td>16</td>
<td>Peace, justice and strong institutions Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable, inclusive institutions at all levels</td>
</tr>
<tr>
<td>17</td>
<td>Partnerships for the goals Strengthen the means of implementation and revitalize the global partnership for sustainable development</td>
</tr>
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</table>

Even though the global public policy-making apparatus has coalesced around the SDGs, they are not without their critics, albeit that these critiques are not fully developed in the academic literature given the recent arrival of the SDGs to the policy stage. There are two areas where we might expect to see concerns emerge, namely in the execution of the Goals and in the ideological commitments inherent in the Goals. These critiques can be predicted as they are also the grounds on which the MDGs and the idea of sustainable development have been critiqued in the past. Governance and execution concerns emerge from a number of sources including: linkages of SDGs to existing governance processes (Kim (2016) explores how the SDGs mesh with international law); the placing of agency at a state level (which is subject to ongoing contestation given globalization, see Sexsmith and McMichael, 2015); and the technologies of control and accountability (including the role of markets) that might be fit for purpose to guide and evaluate actions taken to achieve the SDGs (Biermann et al., 2017). At the core of ideological concerns is the extent to which the SDGs reinforce or challenge a neo-liberal, Eurocentric agenda (Nilsen, 2016; Weber, 2017). In this context, there are longstanding debates that challenge the possibilities for continued economic growth; contest notions of development; and which explore the impact of class, gender and race on life experiences along with consideration of the impact of past and present colonization (see Gore (2015) and Nilsen (2016) for a taste of the elements of these concerns).

None of these problems are resolvable (this is the lesson of wicked problem settings – see Bebbington and Larrinaga, 2014; Biermann et al., 2017) and do not negate the SDGs. Rather, it is relevant to note that despite the enthusiasm for the SDGs, their pursuit will raise points of contestation. What is suggested in their formulation, however, is that we are in new times where “human activity is pushing crucial global ecosystem functions past a dangerous threshold, beyond which the earth might well encounter abrupt, highly non-linear, and potentially devastating outcomes for human wellbeing and life in general” (Sachs, 2012, p. 2207). As such, and despite the issues alluded to above, inaction is not an option.

While a list of goals provides an indication of the aspects that are considered important, it does not illuminate how these goals might relate to one another, nor the underlying drivers of the impacts that the SDGs seek to address (see Griggs et al. (2017) for an extended analysis and synthesis). There is, however, a recognition that the SDGs “are integrated, that is […] each goal incorporates social, economic and environmental dimensions” (Griggs et al., 2014, p. 49). Other analyses (specifically Le Blanc, 2015) seek to elucidate inter-connectivity through identifying which goals the various targets point to. For example, 60 of the 169 SGD targets refer to two or more of the SDGs with 19 targets pointing to three or more SDGs. Le Blanc (2015) also identifies those goals which are most integrated (by way of the analysis of targets), these being the criticality of responsible consumption and production (Goal 12) and the promotion of sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all (Goal 8). These are areas where accounting scholarship might most obviously be linked to the SDGs (see the next section of this paper for a fuller discussion). In the same vein, Storey et al. (2017, p. 98) suggest that responsible management education has “strength in contributing to goals promoting economic growth (SDG 8); industry, innovation and infrastructure (SDG 9); sustainable cities and communities (SDG 11); and responsible consumption and production (SDG 12).”

Other SDG-related literature undertakes a thematic analysis. For example, Hajer et al. (2015) identify four themes around which the goals assemble as being: planetary boundaries, sometimes identified as the climate, land, energy and water nexus (drawing from Rockström et al., 2009); safe and just operating space (drawing from Raworth, 2012 – see also Raworth, 2017); an energetic society (related to models of governance which include more actors and multiple initiatives each of which have their own logics); and green competition, which acknowledges the role of the markets and tones “down the narrative of limits and […] [emphasises] the narrative of opportunities” (Hajer et al., 2015, p. 1656 – see

Achieving the UN SDGs
also Folk et al. (2016) who suggest a similar thematic arrangement). Accounting scholarship is relevant to all these themes (some particular examples are developed in the remainder of the paper).

3. The SDGs and accounting practice and research

To further elucidate the roles that accounting can play in achievement of the SDGs, this section explores the leadership role that elements of the business world and accounting profession are playing with respect to the SDGs. Beyond business and the profession, it also examines how existing research in social, environmental and sustainable development accounting could inform accounting research relevant to particular SDGs, and the knowledge and skills of accountants in enabling areas of measurement, reporting and performance management. The SDGs are likely to further open up new avenues for accounting research, as well as remind us of previous work that has recently been relatively neglected. It is also likely to be the case that a sustainability science framing will be useful. In brief, a sustainability science framing requires two changes to business-as-usual accounting scholarship. First, the subject of the research emerges from problems being faced (rather than the interests of accounting scholars). This makes sustainability science interdisciplinary with contributions being developed by reference to the problem being addressed. The second hallmark of sustainability science is that those affected by problems are full partners in the research (i.e. the work is transdisciplinary). These two aspects fit well with the problem focus of the SDGs as well as reflecting the engaged processes that led to the development of the Goals (see Bebbington and Larrinaga (2014) for a fuller discussion of sustainability science and its relevance to accounting).

3.1 Traction in the business world

Development of the SDGs involved extensive consultation and intergovernmental negotiation from when they were first mooted in 2011 (in discussions preparing for the 2012 United Nations Conference on Sustainable Development – the “Rio+20 Earth Summit”) until they were formally adopted in September 2015. Indeed, commentators describe the process as “hyper participatory” (Scheyvens et al., 2016) and “formulated following one of the biggest consultation exercises the world has ever seen” (Caprani, 2016, p. 102).

Although the SDGs are very clearly an intergovernmental initiative and agreement, committing governments of nation states rather than individuals or businesses to action, the process of developing the SDGs was different from what had gone before due to “the foregrounding of the role of the private sector” (Scheyvens et al., 2016, p. 372). The SDG framework recognizes that government action alone cannot achieve the SDG targets, as this will require concerted action across governments, public and private sector organizations, civil society and individual citizens. As a result, many individuals and organizations involved in sustainable development debates and initiatives would have been aware of proposals for, and details of, the SDGs long before they were formally adopted. Organizations committed to furthering sustainable development thus had time before the formal agreement and launch of the SDGs to consider how an SDG framing could impact on their sustainability policies and practices – including how they could most effectively contribute to attainment of the SDGs.

Among the limited empirical evidence on business engagement with the SDGs, in June-July 2015, PwC (2015) undertook a survey of business awareness and intentions regarding the SDGs. This showed that even before the SDGs had been formally adopted, and six months before they were officially launched, 92 percent of the 986 businesses that responded to the survey were aware of the SDGs – compared to 33 percent of the 2,015 citizens who responded. Clearly, there could be a response bias within this result, with businesses more willing to participate in the survey if they were already familiar with the SDGs through their engagement with sustainable development agendas. However, even allowing for possible
response bias, this still represents a reasonable number of businesses with awareness of the SDGs six months before they were launched. In all, 71 percent of the business respondents indicated that they were actively planning how they would engage with the SDGs, 34 percent indicated that they would focus their attention on a selection of the SDGs, while 1 percent indicated that they “plan to assess their impact on all 17 SDGs” (PwC, 2015, p. 12). However, only 13 percent of the businesses responding had “identified the tools they need to assess their impact against the SDGs” (PwC, 2015, p. 8). This gap between the number of organizations committed to engage with the SDGs and the number who had identified how they would assess their performance in relation to the SDGs they considered relevant indicates a need for new forms of accounting interventions in this respect. PwC have developed accounting tools in this area – such as their SDG Selector and SDG Navigator (Wilson, 2017). However, few accounting academics appear to be working on research explicitly focused on supporting the development (through theoretically informed empirical analysis and/or critique) of the use of (potentially novel) accounting tools in this SDG-related area of emergent practice.

Results of a survey among global CEOs published about six months after the SDGs were launched (Accenture, 2016) showed that the SDGs had by then developed even greater traction and salience among business leaders than revealed in the earlier PwC survey. Among the 1,000 responses to the Accenture (2016) survey, 89 percent indicated that “commitment to sustainability is translating into real impact in their industry” and 87 percent said that they “believe the SDGs provide an opportunity to rethink approaches to sustainable value creation” (p. 1). Accenture (2016) commented that for the first time since their triennial survey was launched over a decade earlier, 2016 saw “business leaders accepting a mandate for radical change, harnessing the [SDGs] as a universal roadmap for action” (p. 1), with 70 percent regarding the SDGs as a powerful framing within which their companies’ actions toward sustainable development could be developed.

While the above two surveys are from credible professional sources, there is scope for collection and analysis of much deeper empirical evidence on these matters – including problematizing the manner in which SGD have been embraced by the business world and the accounting profession. For example, the robustness of results and interpretations of surveys of this nature, including the potential for specific business-friendly neo-liberal appropriations of terms such as “sustainable value creation,” “radical change” and “universal roadmap for action” could benefit from academic scrutiny and critique (see Malsch (2013) for an earlier critique of the role of the profession in defining the grounds on which corporate social responsibility is to be identified and measured).

### 3.2 Traction in reporting

In the reporting arena, several companies quickly incorporated the SDGs into their sustainability reports. For example, in their 2016 Delivering Our Purpose report (BT, 2016), the telecoms group BT incorporated the SDGs into their GRI index (see pp. 56-74 of the report) explaining that “We have used the SDG Compass tool to map our response and increase transparency.” Their report indicated the relevant SDG(s) (if any) for each item in the GRI index. While (as is common and reasonable) many items in the GRI index were identified as not being material enough to be covered in the BT report, the items covered in the report encompassed all of the SDGs – some more extensively than others.

In contrast to BT’s broad approach, Unilever’s (2016) Sustainable Living Plan: Summary of Progress report provided in-depth discussion of those SDGs that were considered most relevant to Unilever’s operations (it should be noted that Unilever’s CEO Paul Polman was a member of the UN High-Level Panel on the SDGs). After explaining the role and importance of the SDGs for both Unilever and society more broadly, the report discussed in depth how Unilever was acting in respect of SDGs 2 (zero hunger), 6 (clean water and sanitation) and 15 (life on land) through: “mainstreaming sustainable agriculture” (Unilever, 2016, p. 18);
supporting the delivery of sustainable access to safe drinking water, sanitation and hygiene” (p. 19); and working to “eliminate deforestation from the world’s commodity supply chains [and] tackling climate change” (p. 17).

The emerging impacts of the SDGs on sustainability reporting, along with insights from the Accenture survey, reinforce the view that the SDGs have rapidly gained traction among large businesses. While the SDGs appear to be accelerating, motivating and focusing the sustainability-related efforts of many of these businesses, they could also be being used (by some organizations, to some extent) to camouflage business-as-usual by disguising it using SDG-related sustainability rhetoric. Academic investigation is needed to help understand where specific SGD-related accounting initiatives lie on the continuum between pure rhetoric and meaningful action, and to inform the most effective use of the SDGs by a broad range of organizations in developing policies and practices that will contribute toward achievement of the SDGs.

3.3 Traction in the accounting profession
The accounting profession has also been quick to comprehend the importance and potential of the SDGs, the substantial engagement by business with the SDGs, and the role the accounting profession can play in pursuing meaningful action within the SDG framework.

Some professional accounting bodies, which have been developing substantive commitments to sustainability and accounting for sustainability over many years, have begun to enroll the SDGs in furthering their championing of accounting for sustainability. For example, the Institute of Chartered Accountants in England and Wales (ICAEW) are among the professional accounting bodies that have “embraced the SDGs as a new framework for their existing commitment to pursuing the public interest” (Wilson, 2017, p. 40). Moreover, the ICAEW’s championing and partnership with the Natural Capital Coalition resonates with the SDG framing and focus. In a recent interview, the ICAEW’s Director of Sustainability, Richard Spencer, explained that the SDGs:

[...] are an articulation by the world of what the world wants, and that actually is a very good articulation of the public interest [...] we have taken the view that this provides an objective standard that we can use to focus our work and it has helped to reposition our vision, to be less introverted as a profession. Our vision now is that a successful economy depends upon and interacts with a successful society and a successful environment (Wilson, 2017, p. 40).

The ICAEW example shows that where a public interest remit is taken seriously the SDGs resonate strongly with the profession’s mission. Using this as a route or justification to raise awareness of the SDGs among accounting firms and consultancies, and encouraging them to promote recognition of the SDGs among their clients, has potential as these firms and consultancies can act as conduits of ideas from one setting or organization to another. In this context, the accounting profession can develop an important role for itself as part of the intervening process in helping translate and adapt the government-level commitments within the SDG targets into organizational-level actions and achievements.

The accounting profession has also been active at a global level in relation to the SDGs. In November 2016, the International Federation of Accounting (IFAC – the global representative body of professional accounting bodies) published a policy document explaining how the accounting profession could help in realization of the SDGs (International Federation of Accounting, 2016). This document resulted from workshops held by IFAC which identified eight of the 17 SDGs as the goals on which the accounting profession could have the greatest impact, and explored how the accounting profession could contribute the most toward achievement of these goals (echoing Storey et al.’s (2017) list). The eight goals selected through IFAC’s processes are:

- Goal 4 – quality education;
- Goal 5 – gender equality;
• Goal 8 – decent work and economic growth;
• Goal 9 – industry, innovation and infrastructure;
• Goal 12 – responsible consumption and production;
• Goal 13 – climate action;
• Goal 16 – peace and justice and strong institutions; and
• Goal 17 – partnerships for the goals.

IFAC’s CEO, Fayez Choudhury, has indicated that with three million accountants being members of the bodies that comprise IFAC, “the skillset, experience, and influence professional accountants possess gives them enormous scope to shape solutions to sustainable development challenges” (Wilson, 2017, p. 41). With the accounting profession identifying a role for accountants in policy and practice, we argue that the accounting academy also has an opportunity to help ensure that SDG-related accounting interventions actually do advance the achievement of the SDGs.

3.4 Accounting research relevant to the SDGs

Since the Brundtland Report (UNWCED, 1987), the academic discipline of accounting has sought to respond to sustainable development in a variety of ways, including:

• tracing the history, possible meaning and ramifications of sustainable development (see e.g. Bebbington, 2001; Gray, 1992, 2002, 2010; Unerman and Chapman, 2014);
• linking accounting techniques that have (and may be) used in support of sustainable development ambitions (see e.g. Atkinson, 2000; Bebbington et al., 2007; Buhr and Reiter, 2006; Crutzen et al., 2017; Figge and Hahn, 2004; Frame and Cavanagh, 2009; Hopwood et al., 2010; Milne, 1996; Russell and Thomson, 2009; Schaltegger et al., 2006; Spence and Rinaldi, 2014; Thomson et al., 2014; Xing et al., 2009);
• considering particular aspects of the sustainable development agenda in conjunction with accounting scholarship (including e.g. carbon accounting, water accounting, accounting and human rights and accounting for biodiversity, see Bebbington et al. (2014) for a synthesis); and
• exploring the ontological, epistemological and methodological ramifications of sustainable development thinking, most often framed under the exploration of sustainability science (Bebbington and Larrinaga, 2014; Bebbington and Thomson, 2013; Frame and Brown, 2008).

Social, environmental and sustainable development-inspired accounting research, which is located at what is now the interface of particular aspects of the SDG goals, also has a long history. For example, there is a critical mass of existing research relating most clearly to:

• SDG 6 – clean water and sanitation (see Hazelton, 2013, 2015; Jenkins et al., 2014; Larrinaga-González and Pérez-Chamorro, 2008);
• a combination of SDGs 5, 10 and 16 – focusing on human rights and equalities (see Arnold, 2010; Haller et al., in press; McPhail et al., 2016; McPhail and McKernan, 2011; Tweedie and Hazelton, 2015);
• SDG 13 – climate action (see Ascui and Lovell, 2011; Bebbington and Larrinaga-Gonzalez, 2008; Brander, 2017; Kolk et al., 2008; Stechemesser and Guenther, 2012); and
SDGs14 and 15 – life below the water/life on land (see Bebbington et al., 2015; Cuckston, 2013; Georgakopoulos and Thomson, 2005, 2008; Jones, 2014; Siddiqui, 2013; Van Liempd and Busch, 2013).

While the above research provides insights that relate to some of the SDGs (individually and in combination) and broader accounting concerns relevant to the SDGs, this work was clearly not undertaken within, or informed by, the SDG framing (as it was undertaken before the SDGs were formulated). The SDGs may therefore provide openings to extend research studies in the above areas to provide ongoing insights that will help advance sustainable development. Issues covered by other SDGs do not yet appear to have prompted accounting-related research projects, but may well be potential sites for future interaction. With this in mind, the next section sketches a research agenda to establish and advance the role of academic accounting in the pursuit of the SDG’s.

4. An accounting research agenda for the SDGs

As explained above, the SDG framing provides an opportunity and need to revisit, redefine and refine the topics and issues studied by social, environmental and economic sustainability accounting researchers – as well as providing opportunities to re-examine the conceptual underpinnings of these fields. Building on these opportunities and needs both for research into the possible roles accounting can play in furthering organizational-level management and operational contributions to achievement of the SDGs, and for broader interdisciplinary research involving accounting, this section seeks to prompt specific areas of work and provide general encouragement to use the SDGs as a way of reflecting upon accounting research. This is not an exhaustive list of possible avenues, but offers suggestions designed to prompt our collective imagination.

In so doing, it is important for accounting academics to appreciate that much of the information and underlying data that will need to be used within meaningful SDG-related accounting practice will probably come from systems that have so far been beyond the boundaries of entity-level sustainability accounting and reporting. Where such systems have been outside the purview of social and environmental accounting academics, this makes embracing interdisciplinarity even more important in a research agenda seeking to enhance the role of accounting in achievement of the SDGs.

4.1 Accounting technologies in SDG analysis

As noted earlier in this paper, the SDGs are underpinned by 169 targets and 232 indicators which are used to monitor progress toward the SDGs as well as to provide data regarding how delivery needs to be adjusted over the period to 2030. These targets can be considered both individually and in terms of combinations between two or more targets and/or between targets and SDGs (Kumar et al., in press). The same kind of process underpinned the MDGs, and indeed various sustainable development target-setting and performance measurement frameworks within the UN. With limited exceptions (see Russell and Frame, 2013, Russell and Thomson, 2009), it is not evident that the academic accounting discipline has been fully engaged in questions of how action for sustainable development can be coordinated or how accounting technologies (e.g. through indicator sets) can be used to steer actions and outcomes. More usually this type of investigation is undertaken by ecological economists (see e.g. Selomane et al., 2015) who have a greater focus on country/region-level analysis. There may also be an opportunity for accountants to collaborate with researchers who work on various spatial scales to see if an integration between data generated in (say) regions and from organizations can be linked so that entity-level measures sit within (and support) regional-level analysis of SDG-related performance (see also the discussion below concerning how entity boundaries are defined).
To achieve meaningful collaboration in this area, it will be necessary for accounting academics to broaden the scope of organizational boundaries and communicative technologies that have traditionally been considered to be the remit of social and environmental (as well as financial and management) accounting. For example, the Accounting, Auditing and Accountability Journal special issue on “Social Media and Big Data” (2017, Vol. 30, No. 4) provides insight into the nature, scope and drawbacks of new media that can be used to collect, synthesize and communicate novel forms of data and is relevant for any attempts to achieve data coherence around SDG analysis (see Arnaboldi, Busco and Cuganesan (2017) for an introduction to the issues).

Papers in the Social Media and Big Data special issue also highlight how big data can be used to provide insights across whole populations rather than just samples. SDG-related accounting interventions can potentially use and develop insights in both of these areas to good effect. But this requires researchers to expand their horizons, moving beyond more familiar forms of organization-centric annual sustainability reporting (such as GRI reports) that have focused on concerns of organizational-level responsibility, performance and accountability, and embracing issues such as novel types of performance indicators channeling the power of various stakeholders articulated through social media and other emerging technologies (Agostino and Sidorova, 2017; Bellucci and Manetti, 2017), and novel visualization technologies coupled with real-time reporting (Arnaboldi, Busco and Cuganesan, 2017). Effectively embracing these new technologies in SDG-related accounting practice may also require changes in the role accountants play in accounting and decision-making processes, with expertise of professionals from other areas becoming increasingly more significant (Al-Htaybat and Alberti-Alhtaybat, 2017; Arnaboldi, Azzone and Sidirova, 2017).

Drawing on the power of new technologies in developing SDG-related accounting interventions may require greater humility than is often the norm among accounting practitioners and researchers. In the words of Arnaboldi, Busco and Cuganesan (2017, p. 769) “[t]he digital revolution seems to offer an opportunity to question and imagine what we cannot know rather than reassure us of what can be measured.” We argue that this observation is likely to apply even more acutely with the challenging multifaceted complexity of achieving the SDGs than it does in the less complex (albeit still very complex) economic world traditionally addressed by financial and management accounting practices and technologies.

These observations point toward the opportunity for accountants to collaborate more closely with governance researchers. In particular, Meuleman and Niestroy (2015) outline the tenants of “metagovernance” – a field which explores how to combine different governance styles, enacted on different scales (global, national and local, for example) into successful and coherent governance frameworks. Meuleman and Niestroy (2015, p. 12298) conceive of governance as encompassing the “totality of interactions […] [including entities such as] government, other public bodies, private sector and civil society” actors. The accounting discipline brings a wealth of knowledge and experience to understanding the possibilities and pitfalls in private sector governance. This focus is also inherent in SDGs 16 and 17 which include the aspirations to “build effective, accountable and inclusive institutions at all levels” (Goal 16) and includes a variety of means for implementation (Goal 17 – Kumar et al. (in press) also place this goal at the apex of their hierarchy of SDGs). We now turn to suggesting some (among a universe of a great many) possible topics for researchers to consider in SDG-related accounting research.

4.2 Re-discovering topics of relevance
The SDGs provide a series of prompts to our scholarly community with respect to topic areas that have particular salience in the pursuit of the Goals. Three relevant aspects are
suggested here as examples: refocusing on economic fairness; putting ecological responsibility back into the heart of analysis; and a renewed focus on the responsibilities of higher education.

For the first of these, Caprani (2016, p. 103) highlight that “the SDGs have been designed with inclusive economic development at the core of the strategy”; albeit that others, such as Weber (2017, p. 4), are critical of the SDGs, seeing them as a “neo-liberal development project”. Regardless, the SDGs highlight for accounting scholars aspects such as economic democracy (see Bebbington and Campbell (2015) for a provocation); tax equity (Christensen and Murphy, 2004; Sikka and Willmott, 2010); and what constitutes fair wages. There are also attempts in this context to develop certifications to provide assurance about corporate actions, including the fair tax mark (https://fairtaxmark.net/, accessed June 28, 2017) and being a certified living wage employer (www.livingwage.org.uk/what-is-the-living-wage, accessed June 28, 2017). These mechanisms warrant, but lack, in-depth and critical academic evaluation (see Ptashnick and Zuberi, 2015). These debates also have resonance with discussions about how we might champion a circular economy (see Murray et al., 2017); prosperity without growth (Jackson, 2009); and also link to the forthcoming Accounting, Auditing and Accountability Journal special section on accounting for (in)equitable organizations and societies and the Critical Perspectives on Accounting call for papers on the role of accounting technologies in the creation of social and societal risk.

In the second suggested research area, that of putting ecological responsibility back into the heart of analysis, SDG commentators are clear that planetary limits are at the core of the Goals (Scheyvens et al., 2016; Sterling, 2016; Caprani, 2016). This is a focus that needs to be replicated in accounting research (see George et al. (2016) and Whiteman et al. (2012) for equivalent work in management). In this context, the Accounting, Auditing and Accountability Journal special issue on ecological accounts in 2017 provides support for this ambition and also highlights the need to critically examine the conceptual distinctions made between nature and culture. These are questions that go to the heart of human-nature relationships and link back to earlier accounting scholarship (see Birkin, 1996; Birkin et al., 2005; Hines, 1991).

Another rationale for the call to refocus on ecological responsibilities lies in the tendency of accounting research to focus on organizations perceived to be significant in terms of size or listed status, which may be different from organizations and contexts of ecological importance (Atkins et al. (2014) and Dey and Russell (2014) demonstrate this contrast). Another example in this area may illuminate this distinction. If one is seeking to interrogate accountability for the governance of endangered species, the accounting entities of relevance are likely to be national governments, conservation agencies and national park authorities. This is because these are the entities who (in many countries) act as custodians of endangered species and who have signed international conventions for their preservation. Listed corporations who operate in the countries where iconic species are endangered (but who are not involved in poaching and/or habitat destruction) are unlikely to be fruitful sites for analysis on endangered species as they are not the responsible entities.

The final example proposed as an area of existing research that might be stimulated by a focus on the SDGs is that of education (for higher education, this would emerge from a combination of SDGs 4 and 17). Academic accountants spend much of their working lives in organizations within which they have a degree of authority, autonomy and influence (for an introduction of this context, see Godemann et al. (2014) and for SDG-specific insight, see Annan-Diab and Molinari (2017) and Storey et al. (2017)). The pursuit of education, as well as participation in the management of higher education institutions, provides a site from which to support the SDGs. One such site where this may take place is under the auspices of the UN’s Principles of Responsible Management Education (see www.unprme.org/resourcedocs/SDGBrochurePrint.pdf, accessed June 28, 2017 and www.unprme.org/news/index.php?newsid=428#WMwZsWekKic, accessed June 28, 2017). Indeed, the Kemmy Business School
at the University of Limerick in Ireland provides an example of how teaching, research and external engagement can be motivated, shaped and tracked by reference to the SDGs (www.unprme.org/reports/KBSPRMEReportJune2016.pdf, accessed June 28, 2017). Drawing on this example, engaging in action research within our employing organizations, redoubling efforts as educators and researching the effectiveness of SDG engagement in educational organizations would be fruitful areas of work for many academics (building on Collison et al., 2014). The above discussion suggests that the SDGs provide a fresh lens through which academics can fruitfully view the accounting field and, in particular, point toward aspects that are currently under-researched. Not only have we seen the energizing effect of the SDGs on the accounting profession, there is also potential for inserting new impetus into existing accounting-sustainable development scholarship.

4.3 Re-examining conceptual commitments
Where new practices and policies emerge from a (claimed or substantive) focus on the SDGs, existing theoretical frameworks may well illuminate empirical work. For example, an interest in the accounts offered by organizations as interpreted though the lenses provided by institutional theory could continue to offer insights. However, it is also the case that social and environmental sustainability accounting is poised to, and urgently needs to, develop some new conceptual frames (Unerman and Chapman, 2014), with the SDG focus likely to accelerate this trend. The need and likelihood of conceptual innovation arises from the nature of the challenges that gave rise to the SDGs (global scale, wickedly complex and post normal – see Frame and Brown, 2008; Bebbington and Larrinaga, 2014; Bebbington and Thomson, 2013) as well as the integrated nature of the goals (across country context, spatial scales and between social, environmental and economic dimensions). This gives rise, for example, to three potential sites for theoretical innovation: challenging definitions of entity boundaries; introducing new conceptual frameworks for analysis; and re-examining the conceptual basis of justice, responsibility and accountability.

Highlighting novel challenges in defining entity boundaries, it is unproblematic to assert “that we live in historically extraordinary times, characterized by hyperconnectivity, complexity, contingency, critical wicked problems and systemic issues – and rapid changes at local and planetary levels, which are mostly on unsustainable trajectories” (Sterling, 2016, p. 209). The SDGs (among other initiatives) seek to address this context. At the individual organizational scale, a concern with externalities has been evident in the accounting literature (Bebbington et al., 2001) with this work highlighting the need to redefine the boundaries of any entity (the usual object of analysis by accounting scholars) in order to understand its full impacts. Likewise, a desire to understand the ultimate impacts of organizational behavior is evident in the work of Collison et al. (2012) and Ferguson et al. (2017) who explore how social outcomes arise from the collective operation of shareholder-orientated capitalism. Both of these types of investigation are relevant to accounting scholarship for the SDGs. What this work also does, albeit not always explicitly, is to create the space within which we might question what entities are relevant for accounting scholarship. There are goals within the SDGs that focus on entities that mediate between scales and which are pivotal to social outcomes. For example, SDG 11 (sustainable cities and communities) and SDG 9 (innovation and infrastructure) focus on entities that are not usually investigated by accounting scholars (see Baker, 2014; Lapsley, et al., 2010; Storey et al., 2017, p. 97, who note the relevance of place as a “unifying and dividing metaphor”). These entities, however, offer rich sites for empirical investigations (this potential was prefigured in the 2010 special issue of Accounting, Auditing and Accountability Journal on cities).

A second area for theoretical innovation builds off this first observation. As accounting researchers become more attentive to the context within which organizations operate,
conceptual frames from policy and geography domains become more relevant. Again, there are papers that already point toward new theoretical framings, including those offered by: governmentality (Gouldson and Bebbington, 2007; Russell and Frame, 2013; Spence and Rinaldi, 2014) and arena studies (Dey and Russell, 2014; Georgakopoulos and Thomson, 2008; Thomson et al., 2015). Moreover, it is likely that careful exploration and engagement with science and technology studies (for an introduction, see Geels (2010)) and resilience (for an introduction, see Walker et al. (2004)) literature will yield potentially useful framing devices for SDG-related accounting studies. What these conceptual frameworks have in common is that they consider systems dynamics and the nesting of impacts across spatial and temporal scales and seek to explain how change happens on multi-scales (see e.g. Starik and Rands (1995) and Whiteman et al. (2012) for related work outside of accounting). Work using these frames might be usefully developed in partnership with cognate disciplines.

Finally, for accounting researchers, the SDGs prompt a re-consideration of the social contract basis for determining corporate social responsibilities (embedded in Rawls, 1971, 2001) and point toward the potential of a capabilities approach (exemplified by Nussbaum (2006, 2011) and Sen (1999, 2009) providing the political philosophical basis for analysis (see Pogge, 1992). Consideration of the relevance of the capabilities approach arises from a number of sources, namely, business ethics explorations of corporate citizenship (Crane et al., 2008); political corporate social responsibility (Whelan, 2012); human rights investigations (McPhail et al., 2016, hint at this connection); and sustainable development work that focuses on what human flourishing/prosperity entails (Jackson, 2009). The SDGs emphasis on “dignity and justice” (Scheyvens et al., 2016, p. 373) makes exploration of the capabilities approach highly pertinent (see also Langhelle, 2000).

Taken together, this section has sought to open up accounting for sustainable development research to empirical contexts and theoretical approaches that are not fully developed in the existing literature. If accounting’s engagement with the SDGs is to reflect and help realize their transformational nature, it should be anticipated that our scholarship will also change – with major developments in both sustainability accounting-focused research and in interdisciplinary research with accounting as one of its disciplinary elements. However, realizing this potential will only be possible if academics have access to sufficient resources to undertake high-quality SDG-related accounting research, and effectively disseminate the outcomes of such research beyond the academic community. The next section briefly sets out some considerations in these regards.

5. Facilitating and disseminating SDG-related accounting research

As indicated in the foregoing sections, addressing the accounting-related research needs and possibilities that are opened up by the SDGs will likely involve research projects focusing on a variety of issues at different levels. While some of these may be undertaken very effectively within the traditional boundaries of social, environmental and financial accounting and accountability academic work, others will need to be part of broader interdisciplinary, multidisciplinary and transdisciplinary projects. It may be possible for some academics to undertake some projects in these areas without additional funding beyond their time funded internally by their universities. However, other projects are likely to require external funding to provide the time of academics and other resources necessary to collect and analyze data, and develop relevant theories, in producing high-quality research insights.

Given the high-profile commitment of some professional accountancy bodies to the SDGs, as set out earlier in this paper, these bodies’ research boards and committees might be a useful source of funding for some SDG-related accounting research projects. However, the professional accountancy bodies tend to have limited resources to fund research, and typically are only able to fund marginal costs of a research project. As a result, larger
projects are likely to require looking beyond the professional accountancy bodies for funding – although professional accountancy bodies are sometimes willing to consider joint funding in partnership with other types of funders.

Governmental and intergovernmental research funding bodies (such as National Research Councils, the European Union and the UN) may be especially receptive to research projects that have clear potential to help further achievements of the SDGs – and thereby help governments (and the UN) deliver on their SDG commitments. Furthermore, government overseas aid agencies and philanthropic foundations may welcome, and be willing to contribute funding toward, SDG-related research projects that clearly have potential to help make the work of the aid initiatives they fund more effective and efficient. Funding applications to many government agencies, intergovernmental agencies or philanthropic foundations are often more likely to succeed if they are jointly funded in partnership with another body (even if not in equal measure) – and joint funding by a professional accounting body (or even a for-profit corporation) could be an important factor in successful research funding bids.

Developing a strong research team is a prerequisite to scoping a successful research project and developing a proposal that forms the basis for a funding application. Identifying the strongest, most experienced and relevant members for the research team often requires building teams across different universities, disciplines and countries. Organizations such as Future Earth and its Knowledge-Action Networks can be particularly important in this regard (see www.futureearth.org/knowledge-action-networks, accessed June 28, 2017). These academic networks can also be important in disseminating the outputs of elements of research projects in a timelier manner than is often possible when researchers are solely focused on publishing their insights in peer-reviewed journals. They can therefore be an important supplement to peer-reviewed journal articles in leveraging policy impacts from SDG-related accounting research. In addition, academics seeking to have the largest possible impact on policy and practice need to consider dissemination through a variety of channels and media outside the academic world that are more likely to be read by policy makers and practitioners (see Bebbington et al. (2017) for a discussion of the complexities of this ambition). Examples of such media are well-established SDG blogs, discussion fora, UN agency (and government agency) newsletters and professional accountancy magazines and conferences. In addition to the academics who are involved in these forms of dissemination, universities are also likely to increasingly value non-academic channels of dissemination as research impact becomes a key performance focus for higher education in more countries.

Finally, given the interdisciplinary nature of the SDGs, even where an SDG-related accounting research project has not been interdisciplinary in its conduct (i.e. it has been undertaken solely by academics from within the social and environmental (and possibly financial) accounting community), it will be important to disseminate its insights through publication in peer-reviewed journals read by academics working on SDGs research in other disciplines. This can be addressed, for example, by submitting papers to a wide range of sustainability-related journals to help academics in other disciplines appreciate the power and potential of accounting policy, practice and research to contribute to realization of the SDGs (see Bebbington and Larrinaga (2014), footnote 20 at page 402 who highlight such crossover outlets).

6. Closing reflections
The UN SDGs represent the “state of the art” thinking of governments around the globe as to the challenges that face the world as well as the mechanisms by which these challenges might start to be addressed. The SDGs require us to act “within our current obsolete development framework to bend environmental and social justice curves as much as
possible, while simultaneously fostering the longer-term shift in consciousness to values and institutions that equitably integrate people and planet” (Sterling, 2016, p. 210 – quoting Rockström, 2015). With this in mind, the purpose of this paper has been to establish and advance the role of academic accounting in pursuit of the SDGs. In pursuing this aim, the paper has proposed three elements of an accounting research community response to the SDGs and their implementation. First, the technologies of accounting, target setting and reporting are required within the UN SDG architecture of “metagovernance” and this represents an opportunity for scholars in evaluating and advancing how accounting is used in these contexts. Second, the SDGs touch upon topical areas that are already researched in some manner within social, environmental and sustainable development accounting scholarship; each of whose parameters and focus may be shaped and transformed by the impetus behind the SDGs. Finally, it has been suggested that there are new avenues for investigation and theorization that are prompted by the SDGs and their connection with “more than accounting” domains of scholarship (including natural science, other social sciences and humanities). While knowing about the SDGs is productive in and of itself, this paper suggests that they provide the opportunity for the accounting for sustainable development academic field to further develop its contributions. The SDGs have already generated engagement across a wide array of actors including, significantly for our purposes, actors engaged with business, accounting and finance. Indeed, one of the hallmarks of the SDGs is that they reflect a consensus “that business had a crucial role to play in achieving transformational global development” (Caprani, 2016, p. 103). Our proposition in this paper is that accounting academics (as a community and in concert with others) can contribute substantively to that challenge.

References


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Abstract

Purpose – While the debate about fair value accounting (FVA) and the global financial crisis (GFC) of 2008-2009 has been explored in the academic and professional literature, there has been little debate about the consequences of FVA being implicated in the crash of Enron around 2001, and the effect of this on later FVA developments and the GFC. The purpose of this paper is to examine how well regulators, political actors, and other commentators may have understood the use, misuse, effects and consequences of FVA at the time of Enron, and to examine how this collective understanding (or lack thereof) has influenced later accounting policy, especially that going into and arising from the GFC.

Design/methodology/approach – Using content analysis, the commentary about FVA is traced through documents, primarily the US Congressional Hearings’ examination of the collapse of Enron that took place between December 2001 and December 2002. An assessment of the knowledge of and attitudes toward FVA is made from these and is then traced through later developments including policy responses before, during and after the GFC.

Findings – Links are found between the collapse of Enron and adjustments to FVA in the mid-2000s, which in turn became implicated in the GFC. These linkages are explored in the context of a fair value world view held by global standards setters in the mid-2000s. During the timeline from the 1990s to the mid-2000s, those advocating and adopting FVA as part of this world view, may have had collectively an insufficient understanding of the consequences or effects of FVA technology.

Originality/value – The study provides evidence of a direct link between Enron, the response of global standard setters, and the GFC controversy.

Keywords Enron, GFC, Politics, Fair value accounting, Standard setting

1. Introduction

Fair value accounting (FVA) is a constellation of techniques that periodically revise financial values, particularly those of financial assets such as shares, options, swaps and other tradeable items. This constellation broadly divides into a rigorous “mark-to-market” version of FVA, that uses verifiable market data of-the-moment as a reference point for these updates, for example quoted stock market prices; and an alternative “softer” collection of techniques called colloquially “mark-to-model” FVA, which allow management to estimate and revise the prices of assets using financial mathematics calculations and assumptions about the asset’s future conditions and prospects (see Table I for a further elaboration on these).

The controversy surrounding FVA and the Global Financial Crisis (GFC) of 2008-2009 is well known, at least in outline. According to the banking industry, and some academic supporters, mark-to-market FVA helped spark the crisis by forcing unrealistic asset write-downs that went into a spiral (e.g. Allen and Carletti, 2008; American Banking Association, 2008; Plantin et al., 2008). Financial assets had to be measured at the prices of the moment, during a temporary crisis, rather than allow for a longer-term recovery. Standard setters and other supporters of FVA replied that the banking industry caused the crisis by poor lending practices and that FVA was its scapegoat (Herz, 2008; Laux and Leuz, 2009; McSweeney, 2009; Roberts and Jones, 2009; Tweedie, 2008). Supporters of FVA lost this argument. Following political pressure, in 2009 the mark-to-market version of FVA was curtailed, and the management-estimate based mark-to-model FVA was more easily enabled (Laux and Leuz, 2010). This more malleable version of FVA, though it was intended to be an emergency fix during the GFC, subsists to the present day, eight years after the crisis “ended.” FVA is now
Historical cost accounting (HCA) | Fair value accounting (FVA)
--- | ---
Asset is carried on balance sheet at the original purchase cost less any depreciation or impairment. Traditional conservative accounting method. Upward revaluations of assets are prohibited or strictly controlled. Upward revaluations generally not recorded as distributable period income but are sequestered in an owners’ equity reserve. When asset is sold a gain or loss is recorded against the purchase cost of the asset less any depreciation that has been applied.

Consistent periodic updating of asset values. Increments and decrements of assets may be taken to period income or (depending on technique) sequestered in a reserve. Increments to asset values may be distributed as dividends even if the asset is not sold and no cash flow accompanies the updated value. Wide variety of updating measurement techniques that divide broadly into “mark-to-market” and “mark-to-model” (colloquial convenience terms with no official definition). Mark-to-market techniques emphasize importance of “observable inputs” to remeasure assets, based for example on recent stock market prices. Mark-to-model techniques emphasize measurements that make assumptions of the assets’ future worth and employ actuarial calculations based on present value of future cash flow and the like. US and IASB standards that specify fair value measurements are a mixture of mark-to-market and mark-to-model. During the 1990s mark-to-model was extensively used and significantly led to the Enron disaster. Mark-to-model was curtailed by standard setters in the mid-2000s and mark-to-market was emphasized instead. Mark-to-market was implicated during the GFC and this led to its curtailment and a return to mark-to-model.

Arguments for HCA
The original purchase cost is more reliable and verifiable than the changing, possibly subjective, values of FVA measurements. HCA is conservative and traditional accounting itself has been innately conservative. It is prudent not to distribute profits on increased asset values until after the asset is sold. (See Walker, 1992; Watts, 2003; Whittington, 2008; Zeff, 2005)

Arguments against HCA
HCA has been subject to management manipulation by hiding increments in assets. Old asset values are not necessarily relevant for decision making. (See Barth, 2007; Laux and Leuz, 2009; Heaton et al., 2010; Landsman, 2007)

Arguments for FVA
FVA measurements are more up to date and therefore more relevant. FVA measurements give a dynamic indication of the firm’s capacity to deal with changing market conditions. Up to date asset values are more relevant to the determination of management performance. (See Barth, 2004; Barth et al., 2001; Francis and Schipper, 1999; Penman, 2007)

Arguments against FVA
FVA has been subject to management manipulation by pre-emptively recording gains that have not yet really arisen. Mark-to-market FVA is criticized for taking a short term view of asset prices during a periodic downturn. Assets must be recorded at the prices of the moment rather than wait for an “expected” recovery. Mark-to-model FVA is criticized for allowing management to manipulate values by using questionable and malleable assumptions of future conditions. FVA may be more relevant than HCA but it is not necessarily more reliable. The “value relevance” to investors of FVA numbers has not been established by academic studies. (See Allen and Carletti, 2008; Holthausen and Watts, 2001; Plantin et al., 2008; Watts, 2006)

Table I. Rival measurement systems
being criticized because it allows corporate managers to manipulate more freely, and to hide losses on failed assets (Glaser et al., 2013; Jarolim and Oppinger, 2012; Milbradt, 2012; Paananen et al., 2012).

Less well known, and much less reported, is that FVA was also embroiled in an earlier, similar controversy, surrounding the crash of Enron and other corporations, around the year 2001. According to Benston (2006), misuse of FVA was largely to blame for the crash of Enron but that, at the time, it was never generally attributed as being a causal factor at all. A case can be made that “Enron and FVA” remain understudied in the literature. This lacuna is important for two reasons. First, a direct link can be drawn between Enron and the response of standard setters to FVA rules, which in turn directly led to the GFC controversy. This paper attempts to establish that link more sufficiently than has been done in the past. Second, the Enron crisis can illuminate much about the collective state of mind of standard setters, regulators and other accounting actors in the early 2000s. These authorities were at the time, in the process of developing what Whittington (2008) would call a Fair Value World View; yet Enron can reveal just how much was apparently understood about the use and consequences of FVA by those who were fervently adopting it as an ideology. This understanding (or deficiency thereof), in turn, helped to drive the problematic set of responses that characterized solutions to the GFC. To understand how standard setters and regulators became seemingly “stuck” with a dysfunctional FVA technology today, we need to understand its historical genesis, and a large part of that genesis can be understood from Enron.

This paper presents an appraisal of Enron and FVA in the literature and addresses the following research questions:

RQ1. How well did regulators, political actors, and other commentators understand the use, misuse, effects and consequences of FVA at the time of Enron’s demise?

RQ2. What was the subsequent effect of Enron’s demise on the further development of FVA standards?

The overall conclusion is one of lessons not learned and of history repeating itself.

The remainder of the paper is organized as follows: Section 2 presents the background to Enron and FVA and provides a concise history of FVA up until 2001. Section 3 presents the empirical evidence to establish the state of FVA knowledge and attitudes in 2001-2002 at the time of the Enron crash and subsequent investigations. A substantial part of the case is made from primary sources: in particular, the post-mortems of the Enron collapse conducted by US authorities. These Congressional hearings run to some 16,800 pages of transcript and, in these, exists a broad indication of what was known about FVA, by whom, in 2001-2002. This section conducts a keyword search of FVA terms and then analyses key speeches by important actors. Section 4 traces chronologically the policy outcomes and world events evidently inspired by or attributable, or traceable, to Enron issues, from 2002 until the present day. This chronology includes changes to the accounting standards themselves, responses and attitudes to these changes from key accounting standard personnel and from the academic world and financial commentators, key historical events such as the destabilizing GFC and Greek financial crisis, in which FVA was implicated, and assessments of the effect in turn of these events and developments upon FVA policy.

2. Background – FVA and Enron

FVA was re-introduced into the US Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) accounting standards in the 1990s. Following the stock market crash and subsequent economic depression of the 1930s, for 60 years FVA (or earlier systems resembling the intention of FVA) had scarcely been practiced.
The 1930s crash had been partially blamed on the overvaluation of assets by FVA-like techniques, which had been practiced haphazardly (Barlev and Haddad, 2002; Healy, 1938; Zeff, 2007). Between the 1930s and the 1990s, the USA (Zeff, 2005), UK (Georgiou and Jack, 2011) and most other countries (Bushman and Piotroski, 2006) relied almost completely upon historical cost accounting, a traditional conservative method, in which upward revaluations of assets were prohibited or strictly controlled. If they were allowed at all, upward revaluations were generally not recorded as distributable period income but needed to be sequestered in an owners’ equity reserve. By the 1960s, however, academics considered the resurrection of a more “scientific” approach to the constant re-measurement of assets (Burton, 1971; Chambers, 1966; Edwards and Bell, 1961; Sprouse and Moonitz, 1962; Sterling, 1967, 1970, 1975; Wyatt, 1963). Some of these were eventually deployed as experimental “inflation accounting” systems (Baskerville, 1996) although the purpose for which they were originally designed encompassed much more than general inflation adjustments.

Although inflation dropped away in the 1990s, other issues led to the partial re-introduction of techniques that came to be called FVA (Whittington, 2015). The motives for this re-introduction did not spring from the holistic “science” of re-measurement systems proposed in the 1960s. Instead, the motives sprang from piecemeal problem-solving. One emergent issue was the series of US savings and loan scandals in the 1980s. These scandals had been blamed on the misuse of historical cost accounting. Insolvent financial institutions hid their losses on tradable securities by using the historical cost accounting method of amortized cost. Paper losses were not booked and could be ignored as long as those securities were still held, but profits could be booked on those securities that had risen in value if they were sold (Johnson and Swieringa, 1996). FVA was proposed as a remedy in the early 1990s, to bring losses as well as profits to account in a timely way. Also, regulators had noticed the rise of financial instruments and sought a way to measure more reliably financial assets that were being rapidly traded (Heaton et al., 2010).

The result was US standard FAS 115, Accounting for Certain Investments in Debt and Equity Securities (Financial Accounting Standards Board, 1993). Following pressure by conservative banks (Schultz and Hollister, 2003), the standard only required some investments, those intended for sale in the short term, to be fair valued through the profit statement. These requirements remained largely unchanged from their inception in 1993 until after the GFC in 2009. At that time, they were incorporated into a new FASB codified standards regime. Other FVA standards, also of mixed measurement, soon followed FAS 115. These included FAS 123, Financial Accounting Standards Board (1995), and FAS 133, Financial Accounting Standards Board (1998). These were attempts to provide fair value measures for the profit statement in selected, limited circumstances.

In 1998, an International Financial Reporting Standard (IFRS) equivalent to FAS 115 was created. IASB standards at that time were called International Accounting Standards (IAS) so the FAS 115 equivalent was IAS 39, Financial Instruments: Recognition and Measurement (Dewing and Russell, 2008; Hodges and Woods, 2004; International Accounting Standards Board, 1998; Walton, 2004). This standard was similar in its application to FAS 115 in that it was a mixed approach of fair value and historical cost. IAS 39 underwent numerous minor changes after its inception, due to complaints about its over-complexity and efficacy (Haswell and Langfield-Smith, 2008). Nevertheless, although this regulatory beginning was a partial and problematic one, by the 1990s, accounting visionaries had pinned their hopes on the new, more advanced versions of FVA that could eventually lead the way to produce accurate valuations of businesses’ performance in the global economy (Barth, 2004, 2006, 2007; Barth et al., 1996, 2001; Francis and Schipper, 1999; Penman, 2007).
While FVA began as a device intended to control financial reporting, it was not long before corporate managers were misusing it for their own purposes, and applying it to uses that were never intended by the regulators. FVA in the 1990s should be seen in context with malfeasance issues affecting other financial accounting standards at the time. The 1990s was a period of economic boom, and an atmosphere of unusually fast-and-loose corporate behavior had crept into Western economies. Regulators soon noticed that accounting rules were being manipulated to book profits (Bolton et al., 2006; Burns and Kedia, 2005; Cheng and Warfield, 2006; Coles et al., 2006; Sanders and Carpenter, 2003; Sunder, 2002). The response to these issues, particularly in the USA, was an ever-burgeoning increase in the complexity of accounting rules (Haswell, 2006). This later became known (derisively) as the “rules-based solution.” Accounting standards had blown out to hundreds of pages of implementation guidance, yet corporate managers still were manipulating the standards’ intentions. Regulators and corporations became bogged down in endless litigation over the alleged abuses.

FVA was eventually to join this list of abuses, but it was not recognized immediately as a problem. This paper supports the case that, although regulators and standard setters were well aware of other manipulations, such as manipulation of revenue recognition, or of accruals, they seemed strangely unaware of, or unresponsive to, fair value manipulation until a few years after the Enron crash. When the GFC developed in 2008, the subject of manipulated financial products returned to the attention of commentators. Although the products manipulated during the 2008-2009 GFC were often different to those manipulated by Enron and dot.com companies involved in the earlier crisis, the same basic principles of manipulation would apply to many companies: management estimates would be used to value products initially and to book profits as the market was rising. However, as managers became dependent on the inflated amounts to pay bonuses, changes to the estimates would not be recognized as losses. Literature now exists on this syndrome, which is associated with a rise in trading in financial assets and a decline in the manufacturing economy. Critics call the syndrome “financialism.” In this view, it was FVA that helped to enable financial assets prices to be manipulated into a bubble in the first place (e.g. Callon, 2007; Davis, 2009; Dumenil and Levy, 2004; Hancke et al., 2007; Heise, 2008; Krippner, 2005; MacKenzie, 2007; Perry and Nolke, 2005, 2006; Roberts and Jones, 2009; van Treeck, 2009).

Extreme cases of accounting manipulation led, however, to an era of wholesale collapses of companies. Enron was one of the first large corporations to collapse (very visibly) during the “dot.com” crisis in the early 2000s. Although Enron started out in the 1990s as an energy producer, near the end of its life it owned few physical assets and was little more than a financing company. While Enron itself was not strictly a “dot.com” company (though it did make a large amount of booked profit on broadband services) it is all the same a prime example of the “financialization” of companies at that time and, like the dot.com companies, it collapsed when perception of its profit making abilities far exceeded reality. Much has been written in the academic literature about Enron’s use of special purpose entities (SPEs) and complex contracts designed to disguise non-existent booked revenue, and its relationship with auditors (Abdel-Khalik, 2002; Benston and Hartgraves, 2002; Demski, 2002; Revsine, 2002).

Enron also made extensive use of modeled fair value measurements to manipulate asset values, but these uses were not much recognized for some time after the events. In 2006, George Benston produced an article that seems intended to startle the academic accounting establishment. Benston (2006) wrote that “Enron’s use of fair-value accounting is substantially responsible for its demise” (p. 466). The article had come five years after Enron’s collapse, and three or four years after a plethora of post-mortems designed to get to the bottom of what happened. That Enron (and other companies) had crashed because of FVA seemed to be new information. Benston (2006) writes that “few if any” authors have
described “[…] how fair-value numbers not grounded on actual market prices have been misused and abused” (p. 466). Such a claim might seem surprising today, given the large amount of literature cited above, available certainly since 2008, concerning manipulation of mark-to-model measurements.

In the late 1990s, Enron fraudulently booked billions of dollars in non-existent revenue (Partnoy, 2003). At the same time, management salaries and bonuses based on these profits increased exponentially; the top 200 employees took home $193 million in 1998, $402 million in 1999 and $1.4 billion in 2000 (i.e. an average $7 million each), just before the company collapsed (McLean and Elkind, 2003, p. 241). Enron’s collapse was the beginning of an avalanche. Many other corporate collapses followed at the beginning of the 2000s. These companies included WorldCom, Global Crossing, Tyco, Sunbeam, Parmalat, Qwest and many others (Chorafas, 2006; Clark, 2007). There is a capital markets research viewpoint that accounting numbers do not “fool” the market (Ball and Brown, 1968; Kothari, 2001; Lev and Ohlson, 1982). Despite years of Enron’s and other companies’ financial reports being accepted by financial analysts, investors, authorities and the “market,” their failure presents a challenge for that viewpoint. Perhaps these market failures, on such a gross scale, present a significant challenge.

Notwithstanding the massive amounts of these frauds and the popular books published on the subject, “Enron and FVA” received little or no attention in the academic literature before Benston’s article in 2006. Sporadic mention of Enron and fair value can be found in the professional literature of the mid-2000s, just before Benston’s article. Flegm (2005, p. 5) writes in December 2005 of Enron that “Surprisingly, no regulatory body, including Congress or the SEC, has criticized the FASB for its part in enabling frauds.” Flegm writes that misuse of fair valued derivatives was central to the accounting frauds of Enron, Qwest, Global Crossing and Parmalat, and gives a brief illustration of one of the Enron mis-measurements. A year later, in November 2006, apparently inspired by Benston’s and Flegm’s articles, Haldeman (2006) provides a more extensive analysis of Enron’s FVA for the professional literature. These articles seem to represent the beginning of an examination of fair value problems in the accounting literature. These authors claim and express surprise that the fair value issues of Enron were not greatly recognized or discussed at the time of the Enron post-mortem in 2002. Haldeman (2006, p. 4) writes, for example, that “Despite its likely overstatement of fair asset values, Enron’s use of fair value accounting was never an issue in the criminal case against Enron executives Lay and Skilling.”

Benston’s article, and its surrounding, if scant, professional literature on the same topic, leave a number of questions unanswered. How exactly, as Flegm suggests, did the FASB “escape criticism” for Enron? If this was, partly, a matter of being able to “understand” FVA, what really was the extent of this understanding held by regulators, political actors, and other commentators at the time? Answers to these questions will help to explain how the responses of standard setters and regulators led to the protocols that later became problematic in the GFC. One vehicle for such a study readily exists in the vast documentation of Enron’s post-mortem.

3. FVA and the Enron hearings

After the company’s collapse in late 2001, US Congress became, for a time, obsessed with Enron. Between December 2001 and December 2002, US congressional committees examined the Enron disaster in 42 separate hearings (Library of Congress, 2014). These hearings are summarized in Table II. The hearings were all of a large-scale and in each of them, Enron was either discussed extensively or was the only topic of discussion (in almost all the hearings “Enron” is part of the title). Transcripts of these hearings run to some 16,600 pages (including supporting documents and written reports) and involve the testimony of hundreds of expert witnesses from the highest levels of accounting, finance, legal and
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bureaucratic establishments. It seems evident that, notwithstanding that these were in some degree political meetings, beliefs held toward Enron, in 2002, may have been fairly well represented within the transcripts of these hearings.

An analysis of the Enron hearings reveals that even in the hearings supposedly dealing specifically with accounting issues, fair value was not widely mentioned or discussed. The focus was, instead, on Enron’s use of SPEs, loopholes that avoided consolidation, intra-group booking of fictitious revenue not remedied by consolidation, and audit malfeasance. This focus confirms that FVA was not widely ascribed as being a cause of the Enron crash. However, the hearings that do mention FVA illuminate much of the FVA collective state of mind at the time. A keyword search of testimony transcripts was made for the terms “fair value” or “mark-to-market,” as shown in Table II. It should be noted that, throughout all the hearings, the terms “fair value” and “mark-to-market” are used without rigor or precise distinction, and the terms seem to be more or less interchangeable in their intention. The difference between mark-to-market and mark-to-model types of fair value is a subtlety that gained popularity for discussion only in the late 2000s (and even then, the nuanced difference was only observed by some people). Given, though, the ubiquitous, official use of the term “fair value” in the relevant accounting standards such as FAS 115, it was thought that any meaningful discussion of FVA would involve usage of this term or its popular (at the time) analog term “mark-to-market.” It is possible that oblique discussion of fair value issues, for example, the present value of revenue from forward contracts could have been made without reference to the key terms; however, a meaningful discussion of accounting issues arising from such material does not seem likely without the use of the key terms.

Overall, in 22 of the 42 hearings, the terms “fair value” (or “mark-to-market”) are not mentioned at all, that is, there is completely no discussion of that topic. So, in hearings with titles such as “Oversight of investment banks’ response to the lessons of Enron” (two volumes, December 11, 2002) and “The Enron collapse: implications to investors and the capital markets” (February 4, 2002) the issue of FVA is not discussed at all. In the 20 hearings where fair value or mark-to-market are mentioned, in some of these mentions (five hearings) the term “fair value” is observed once or twice in passing, but with no elaboration. In the remaining 15 hearings, fair value is discussed to a varying extent, but as the following analysis will show, it is only discussed in any detail in seven of the 42 hearings.

The hearings in Table II are presented in date order. As the presentation of material at one hearing might have influenced the next, discussion of the hearings in date order will be useful. In the first hearing on December 12, 2001, “mark-to-market” was discussed briefly (Congressional Hearing, 2001). The first discussant of fair value issues was SEC Director Robert Herdman. His testimony begins:

I don’t know that there’s any evidence to indicate that mark-to-market accounting has led to misleading information to investors. The broker-dealers in this country have used mark-to-market accounting to account for their activities for many, many years. They have sophisticated financial instruments that aren’t quoted on exchanges that need to be accounted for at market value. And so estimates need to be made of value in order to accomplish the mark-to-market process […] we haven’t seen any indication that the mark-to-market accounting has caused problems for companies within the energy industry. If we do, we would certainly expect that there might be a need to tighten up the accounting rules here (Congressional Hearing, 2001, p. 24).

Later in the hearing, an expert representing investment banking was more circumspect:

[…] it was becoming increasingly difficult to understand how Enron was achieving its revenue growth and profitability. Extensive use of derivatives, particularly when the company is using mark-to-market accounting, is extremely difficult in the best of situations (Congressional Hearing, 2001, p. 50).

But the discussions, or prepared statements provided, never went beyond this level of generality. January 29, 2002 hearing was about Enron’s manipulation of energy prices.
There was a more extensive discussion of Enron’s accounting procedures, but the material on fair value was, while “alarming,” very cursory:

Equally dangerous was Enron’s use of mark-to-market revenue and earnings accounting. Enron apparently calculated the proceeds from multi-year transactions based on values from forward markets that are thin at best and non-existent at worst. One industry pundit called depending on forward markets in electricity as pricing by rumor. If mark-to-market is used, the assumptions behind the calculations must be open for review (Congressional Hearing, 2002d, p. 41).

Note the industry pundit, referred to in the above extract, who describes FVA as “pricing by rumor,” an elegant (if unelaborated) piece of cynicism in stark contrast to the regulators’ depictions. The February 6, 2002 hearing, titled “Lessons learned from Enron’s collapse: Auditing the accounting industry,” discusses fair value in a way similar to the January 29 hearing, and never gets beyond the level of summary generality about the possible dangers of “mark-to-market.” For example, one witness (an accounting Professor, Bala Dharan of Rice University) remarked that:

Enron’s revenue recognition from SPE transactions often depended on the so-called mark-to-market accounting rules, which gave Enron the ability to assign arbitrary values to its energy and other business contracts (Congressional Hearing, 2002a, p. 93).

But there is no specific detailed analysis of Enron’s financial position; there is little more than suspicion or hearsay. This is the common theme for most of the hearings, even though these hearings lasted a year, and there was time to develop such detail. In the February 7, 2002 hearing before the House Committee, many of the Enron executives were brought in to testify. Congressman Waxman said:

According to press accounts, Enron pushed the limits of mark-to-marketing [sic] accounting, which allows a company to recognize all revenues upfront on a long-term contract. In order to determine the profitability of a contract, Enron had great leeway to make assumptions about future energy prices, energy use and other factors. The New York Times reported that Enron Energy Services, or EES, deliberately used questionable revenue assumptions to inflate its profits, and the vice chairman of EES at the time that these questionable practices were occurring was Thomas E. White, who became the secretary of the Army in May 2001. A former EES employee called this accounting practice a license to print money. Mr Olson, did Enron abuse market-to-market accounting, in your view?

Mr OLSON. I am not an accountant, Congressman. From what I read in the press as well, there was certainly – they were stretching the limits, and I think what you are alluding to is what is called a variation on that mark-to-model accounting, where you go out and make these assumptions which may or may not work out (Congressional Hearing, 2002b, p. 88).

Olson was a securities expert, brought in to give advice to the committee. The Enron executives were asked similar questions but gave vacuous and evasive answers, and were not pressed on those. The hearings on “Accounting reform and investor protection” beginning on February 12 have the largest mention of fair value issues. Richard Breeden, the SEC Director highly involved with sponsoring fair value in the early 1990s (Breeden, 1990), was an early witness. Breeden did not mention fair value issues regarding Enron at all (Congressional Hearing, 2002c, pp. 16-19). By contrast, Walter Schuetze, the chief accountant of the SEC at the time of Enron, gave an extensive and vivid description (around 20 pages) of the importance and high value of FVA, and the great degree of interest and regard held to it by the SEC. He said:

The only objective way that the true economic financial condition of a corporation can be portrayed is to mark-to-market all of the corporation’s assets and liabilities [...] The various proposals that have been made to cure Enronitis will not cure the problem. The only cure, in my opinion, is mark-to-market (Congressional Hearing, 2002c, pp. 191-192).
It is not clear if Schuetze meant that Enron’s use of fair value was not sufficiently extensive or that it was extensive but the wrong type of fair value (mark-to-model rather than mark-to-market). Several years later, a commentator remarked that Schuetze “pioneered new ground for evading responsibility for financial statements” (Haldeman, 2006, p. 9). Through his strong advocacy for the maximum use of FVA, the accuracy of which would be determined not by management, or auditors, but by “outside experts,” Scheutze was said to have made a recipe for endless blame shifting. In the hearing, he went on to complain that private standard setting, such as in the FASB, was a failure and that Congress should mandate uniform mark-to-market accounting, to relieve FASB of that responsibility. “Mark-to-market is extremely simple” he said (Congressional Hearing, 2002c, p. 204). Denis Beresford, a former chairman of the FASB, stated that:

Mark-to-market generally means that amounts recorded as assets or liabilities in the balance sheet are adjusted at the end of each accounting period to the estimated fair value at that date. The above items were either omitted from Enron’s financial statements or incorrectly shown as assets and equity rather than being offset.

On the other hand, Enron did use mark-to-market accounting in connection with its energy and other trading activities. To the best of my knowledge, no one has suggested that Enron was not following Generally Accepted Accounting Principles in doing so. However, I understand that for many of these contracts the estimates of period end values involved predictions of energy and other prices several years into the future. While mark-to-market accounting is considered by many accountants to be the most relevant way to report contract positions, others point out that the resulting values may not be very reliable in some cases (Congressional Hearing, 2002c, p. 270).

This theme is crucial. Some experts questioned the looseness of FVA measurements, but the experts were not at all sure that these measurements were done improperly or done outside of accounting standards’ intentions. In the February 13 hearing (Congressional Hearing, 2002d), expert witnesses observing the energy industry argued that mark-to-market accounting allowed Enron to book revenues prematurely though no specific details were supplied. In the February 14 hearing, Edmund Jenkins, chairman of the FASB, clarified the FASB’s position on FVA and Enron. The position was identical to that taken by the chairman of the SEC, namely, that there was no evidence that mark-to-market accounting had caused any problems (Congressional Hearing, 2002e, p. 25). However, Jenkins did clarify the FASB’s understanding of “mark-to-market,” quoting from FAS 107, paragraph 11:

> Quoted market prices, if available, are the best evidence of the fair value of financial instruments. If quoted market prices are not available, management’s best estimate of fair value may be based on the quoted market price of a financial instrument with similar characteristics or on valuation techniques (for example, the present value of estimated future cash flows using a discount rate commensurate with the risks involved, options pricing models, or matrix pricing models).

Under this depiction, all techniques of FVA are equally described as “mark-to-market.” In the same hearing, other witnesses flatly contradicted the assertion that the fair value standards were unproblematic. Congressman Radanovitch said, in a prepared statement:

The Enron Special Investigation Committee uncovered dozens of transactions with special purpose entities effectively controlled by the company to hide bad investments. In California, Enron used one of their SPEs to form Azurix, a water trading company that dissolved this year, but not before a handful of executives made millions. In aggregate, these transactions were used to report over $1 billion of false income through mark-to-market accounting and hide the decline in Enron’s asset value. Such transactions should reflect true market conditions, and not false prediction made up of twenty-year forecast (Congressional Hearing, 2002e, p. 9).

The Special Committee mentioned by Radanovitch was an internal investigation by Enron directors. “Mark-to-market” is mentioned six times in that 218-page report, but not in a way that
ties it to an overstatement of income (Enron Corporation, 2002); that claim seems to be an interpretation of the Congressman. But the SEC and FASB representatives were never challenged rigorously over these claims. There were a few further polite, very general, inquiries made by committee members about fair value, which engendered responses (brief denials that fair value was a problem) only at the most general and perfunctory level. After this hearing, and for the rest of the year, FVA was scarcely mentioned during the remaining Enron hearings.

To summarize the Enron hearings, there was certainly a sense from some of the expert witnesses that Enron and other companies were mal-using FVA in a highly problematic and significant way. These witnesses struggled to make any impression upon the committees. The SEC and FASB witnesses were easily able to deflect the fair value issue onto other accounting, corporate governance or regulatory issues. Whether they did so in a genuine belief that fair value was unproblematic is open to question. What comes across strongly, especially from Walter Schuetze’s vivid and detailed testimony, is the extent to which fair value had become a cause celebre within the SEC, following Richard Breeden’s term of office. But the level of technical detail provided to any of the committees was very superficial. These Congressional hearings are certainly political meetings. But the Enron hearings were also extensive and were taken seriously as a probative investigation of the disaster. Perhaps it might have been expected, in around 17,000 pages of testimony, and during the course of one year, to see at least one commissioned technical report, one report that probed Enron’s use of fair value numbers in an academically or technically rigorous way. There were none.

Arising from the Enron hearings we are left with a choice of two impressions. One is that, in 2002, the technicalities of fair value measurement, those being actually carried out in the workplace, were not well understood by SEC, FASB and many other authorities, nor were the consequences or misuse of FVA technology well understood. An alternative impression is that SEC, FASB and other leaders perhaps did understand the use and misuse of FVA rather better than they were willing to say publicly, but in effect these authorities performed a cover-up of what they knew to be problematic about FVA. Either way, it is not hard to see how FVA largely escaped blame for the Enron crash, as suggested by Benston (2006).

4. The Enron effect, the fair value world view in the mid-2000s, and the GFC

The limited (or hidden, or fragmented, or confused) understanding of FVA’s role in these corporate collapses perhaps helps to explain the tangent that preoccupied the literature in the early 2000s. Instead of seeing Enron as a fair value problem, accounting issues were summarized as a “rules versus principles problem” (Nelson, 2003). The IASB had taken the moral high ground after Enron by insisting that its standards were superior because they were based on “principles” rather than rules (Tweedie, 2002, p. 110). In prior decades, the IASB had been seen as less powerful, and subservient to the FASB (Flower, 1997; Haswell and McKinnon, 2003; Zeff, 1998). After the Enron scandal, US accounting lost some of its prestige and credibility. FASB was forced into a cooperative pact with the IASB in which, officially at least, the two were more or less equal collaborators. Announcements were periodically made of intentions to “harmonize” the two regimes (Bhimani, 2008; Carmona and Trombetta, 2008; Chiapello and Medjad, 2009; Chua and Taylor, 2008; De Lange and Howieson, 2006). After a short time, some commentators were pointing out a phony aspect to the rules and principles debate, as rules and principles were not that easy to distinguish (Schipper, 2003). IFRS also had standards that were full of voluminous implementation guidance, or “rules.” The financial instruments standard, IAS 39, with several hundred pages of fair value guidance, and the subject of numerous complaints about its over-complexity (Bryer, 2004), was a prime rules-infested suspect (Nobes, 2005).

However, while FVA malfeasance seems to have been largely ignored by the academic world in the period 2000-2006, warnings about FVA, given by some securities experts (as evidenced at the Enron hearings), soon appeared in bestselling “popular” books
about Enron (McLean and Elkind, 2003; Partnoy, 2003) and, eventually, trickled through to detailed investigation by academic and professional accounting writers. McLean and Elkind (2003, p. 39) write:

Even before joining Enron, Skilling had made a very strange demand. His new business, he told Lay, had to use a different type of accounting from the one ordinarily used by the natural gas industry. Rather than use historical cost accounting like everyone else, he wanted Enron Finance be able to use what is known as mark-to-market accounting. This was so important to him – “a lay-my body-across-the-tracks issue,” he later called it – that he actually told Lay he would not join Enron and build his new division unless he could use mark-to-market accounting.

Skilling was adamant about this particular accounting method because:

He’d never let go of the consultant’s conceit that the idea was all and the idea, therefore, should be the thing that was rewarded. He felt that a business should be able to declare profits at the moment of the creative act that would earn those profits. Otherwise, businessmen were mere coupon clippers, reaping the benefits of innovation that had been devised in the past by other, greater men. Taken to its absurd extreme this line of thinking suggests that General Motors should book all the future profits of a new model automobile at the moment the car is designed, long before a single vehicle rolls off the assembly line to be sold to customers. Over time, this radical notion of value came to define the way Enron presented itself to the world, justifying the booking of millions in profits on a business before it had generated a penny in actual revenues (McLean and Elkind, 2003, p. 40).

McLean and Elkind (2003) report that, in 1992, Enron actually sought and obtained the SEC’s approval to use mark-to-model-type calculations (the authors use the term “mark-to-market” in a non-rigorous manner), on booking income in advance from natural gas futures contracts; Enron was, therefore, the first company to deploy this type of accounting in the energy industry (p. 41). By 1997, Enron was using FVA in every aspect of its business (McLean and Elkind, 2003, p. 127). McLean and Elkind make it clear that mark-to-model FVA was the essential accounting conduit for Enron’s measurement malfeasance. They provide general descriptions of these accounting procedures and the Enron activities, along with some headline profit and loss numbers, but the material would not be described as a technical accounting analysis. It does seem hard to explain why another three to four years would go by before academic accountants would pick up this theme, to present reports on it in more detail.

Benston’s article then appeared in 2006. He provides a detailed technical analysis of Enron’s use of fair value in numerous of its projects. For example, in 2000, Enron announced a 20-year project in conjunction with Blockbuster Video to supply TV movies:

However, Enron did not have the technology to deliver the movies and Blockbuster did not have the rights to the movies to be broadcast. Nevertheless, as of December 31, 2000, Enron assigned a fair value of $125 million to its Braveheart investment and a profit of $53 million from increasing the investment to its fair value, even though no sales had been made. Enron recorded additional revenue of $53 million from the venture in the first quarter of 2001, although Blockbuster did not record any income from the venture and dissolved the partnership in March 2001. In October 2001, Enron had to announce publicly that it reversed the $110.9 million in profit it had earlier claimed, which contributed to its loss of public trust and subsequent bankruptcy.

Anderson [the auditor] assumed the following: (1) the business would be established in 10 major metro areas within 12 months; (2) eight new areas would be added per year until 2010 and these would each grow at 1% a year; (3) digital subscriber lines (DSLs) would be used by 5% of the households, increasing to 32% by 2010, and these would increase in speed sufficient to accept the broadcasts; and (4) Braveheart would garner 50% of this market. After determining (somehow) a net cash flow from each of these households and discounting by 31-34%, the project was assigned a fair value (Benston, 2006, pp. 474-475).

The revenue was booked by making assumptions about trading activities that might or might not happen years into the future. Benston’s point is that it would have been very
difficult to book these unrealistic revenues without the aid of FVA. While historical cost can also be misused, it is a question of degree; and Enron’s abuses were exceptional. In hindsight the Enron and related episodes might be termed the first fair value crisis, but at the time, fair value was only one of numerous factors attributed to these collapses. Therefore, the GFC would be the second fair value crisis, in reality, a continuation of the first (see Table III for a chronology of events).

While the FASB seemed to have a poor understanding of its own FVA protocols in 2001-2002, this was to change. By the mid-2000s, it was evident that the FASB had at least learned, certainly from the studies of Enron that came well after the Congressional hearings, that mark-to-model FVA was a problem. In 2008, Gwilliam and Jackson wrote that:

IAS 39 in its present form, […] SFAS 157 and the joint IASB/FASB projects relating to both fair value accounting and the underlying conceptual framework all postdate Enron, although the extent to which they have been directly influenced by the Enron saga is open to debate (p. 256).

<table>
<thead>
<tr>
<th>Action</th>
<th>Reaction</th>
<th>Outcome/Consequence</th>
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<tbody>
<tr>
<td>1920s – FVA-like procedures boost profits on financial assets</td>
<td>FVA implicated in boom and subsequent 1929 bust</td>
<td>US prohibition of FVA from 1930s</td>
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<td>1990s – misuse of historical cost accounting and the rise of financial instruments</td>
<td>Partial (re)introduction of FVA to combat perceived historical cost inadequacy</td>
<td>Door open for (mis) use of FVA</td>
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<td>2001 – collapse of Enron, FVA and the use of management estimates/predictions to measure assets and liabilities implicated in the collapse. Yet management estimates/predictions were allowed within US GAAP (in 1992 Enron received SECs’ permission to use mark-to-model)</td>
<td>2002 – At congressional hearings, SEC and FASB deny link between FVA and Enron collapse</td>
<td>Technicalities of FVA measurement carried out in the workplace not well appreciated by standard setters, professionals and other commentators. After a hiatus of several years, FASB quietly begins work on new FVA protocols to curtail mark-to-model accounting. In retrospect, Enron was the First Fair Value Crisis Convergence program</td>
</tr>
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<td>2002 – IASB sees Enron and US GAAP as rules vs principles problem</td>
<td>Commentators point out phony aspect of the juxtaposition</td>
<td>2006 – the academic community finally picks up on the warnings about FVA malfeasance</td>
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<tr>
<td>2003 – McLean and Elkind write popular book The Smartest Guys In The Room</td>
<td>2005 – Professional commentators give warnings about FVA</td>
<td>Measurement basis became politically problematic in the GFC when US and other financial systems started to freeze and banks refused to trade each other’s financial assets. Mark-to-market accounting blamed for spiral of collapsed prices.</td>
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<td>2006 – FAS 157 Fair Value Measurements – FASB introduces three level hierarchy with strong preference for Level 1 (mark-to-market accounting), even when markets thinly traded. But mark-to-model was not disallowed</td>
<td>2006-2008 – IASB also shows a clear preference for measurements consistent with Level 1 exit price, observable inputs even when markets are thinly traded</td>
<td>In reality, the GFC is the Second Fair Value Crisis</td>
</tr>
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<td>2008-2009 – Pressure from US and European politicians to modify FVA</td>
<td>2009 – FASB and IASB revised standards such that mark-to-market (Level 1) did not need to be used when a market is considered inactive, with liberal definition of “inactive”. IASB also allowed switching of some FVA measured assets back to historical cost</td>
<td>In 2018, these measurement protocols remain basically unchanged</td>
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**Table III.** Enron, fair value accounting and financial crises: a concise history
Certainly, the internal processes of the FASB and IASB are opaque to an extent, but, in fact, there is sufficient evidence to draw a direct link between Enron and FAS 157 and the later convergence projects. In March 2003, Robert Herz, chairman of FASB, appeared before a US House congressional hearing titled “A review of FASB action post-Enron and Worldcom” (Congressional Hearing, 2003). Most of the discussion was about SPEs that had been mis-accounted (had been deliberately omitted from consolidations) by Enron, and for which the FASB had already approved a new set of rules called FIN 46, Consolidation of Variable Interest Entities (Financial Accounting Standards Board, 2003; Haswell, 2006). There was very little discussion about FVA itself, but buried in Herz’ (2003, p. 8) statement was the advice that:

FASB staff observed that no enterprise should recognize an up-front gain at the inception of entering into certain financial contracts unless the fair value of those contracts is clearly evidenced by observable market transactions or market data.

We also have a current project on our agenda to improve the existing accounting requirements for measuring and disclosing the fair value of essentially all financial instruments.

In the excerpt’s latter section, Herz is referring to the exposure draft “Fair Value Measurements” (Financial Accounting Standards Board, 2004) that appeared the following year in June 2004, and which later became FAS 157, Fair Value Measurements (Financial Accounting Standards Board (FASB), 2006). Therefore, the linkage of that standard with Enron is quite direct. The first part of the excerpt is also an oblique reference to Enron. As McLean and Elkind (2003) and Benston (2006) had discovered, most of the controversial accounting at Enron was about “up front” fair value recognition of revenue. Plainly, FASB was concerned about mal-use of mark-to-model estimates that calculated these revenue amounts. The next part of the statement, “observable market transactions or market data,” though it went unremarked and made no obvious impact upon the congressional hearing, was to become the sin qua non of the FASB’s approach to fair value as the world went into the next financial crisis. In essence, the response of the FASB to Enron and other episodes of accounting malfeasance was not to question the suitability of FVA itself, but simply to revise and supposedly toughen the allowable methods. FAS 157, with the SEC’s active support, would all but disallow mark-to-model accounting, and would stipulate that observable market transactions be used whenever possible. In a later interview in 2007 (just before the GFC controversy over fair value), Herz said that:

People who don’t like fair value accounting usually cite Enron as a reason. Enron is an example of what I’ll call “unfair value,” using “mark-to-model” accounting without further adjustments to properly reflect fair value (Kranacker, 2007, p. 6).

The evidence seems definitive. The FASB had learned from Enron that mark-to-model accounting was extremely problematic. The FASB had obviously realized that they were losing control of their own technology, so had developed a new incarnation of that technology, FAS 157. The protocol introduced in FAS 157 is called the fair value hierarchy. There are three steps in the hierarchy, as follows:

1. Level 1 measurement: based on directly observable inputs (e.g. from quoted market prices).
2. Level 2 measurement: based on surrogates for observable inputs.
3. Level 3 measurement: based on management modeling, for example of expected future cash flows and recoverable amounts.

In the literature, Level 1 is referred to as mark-to-market accounting. Level 3 is referred to as mark-to-model accounting. While Level 2 could be described as a form of mark-to-market,
others draw finer distinctions. For example, Jarolim and Öppinger (2012) describe Level 2 as mark-to-model with market parameters and Level 3 as mark-to-model without market parameters. In the Fair Value World View described by Whittington (2008) "exit" prices based on observable transactions were the most desirable basis for measurements in the "neoliberal markets" framework. While Level 1 is clearly an "exit price" measurement, Level 3 is arguably not, and Level 2 is ambiguous because it could also involve management "estimates" of surrogate prices.

While the protocol had three levels, in 2006 the standard setters clearly preferred the use of Level 1, i.e. mark-to-market. FAS 157 made it clear that FVA was intended to be an exit-price, observable inputs measurement even when markets are thinly traded. The standard did mention the problem of forced sales (FAS 157, paragraph 7), but thin trading does not itself amount to a forced sale. It is not necessary for a market in financial assets of the same description to exist to obtain market prices for those assets. Instead, these can be inferred from an orderly market of similar assets (FAS 157, paragraphs 28-31). In summary, income valuation models, especially unobservable Level 3 inputs, generally could not be used if quoted prices, or quoted prices of surrogates, were available at all. The standard, therefore, prioritized short-term market measurements and did not generally allow the company to take a modeled longer-term view that "assumes" the assets will necessarily recover their sale price potential. During the development of FAS 157, the SEC, obviously operating in tandem with the FASB, had supported this emphasis on observable inputs as a matter of policy. The SEC made it clear in an accounting and auditing enforcement release that observable inputs, assessed in the immediate term, were the preferred measure (Securities and Exchange Commission, 2004). These requirements were to have far-reaching consequences when, in 2008, the US financial system started to freeze, and banks refused to trade in each other’s financial assets, thus creating thin or non-existent markets (Nanto, 2009). In 2006, the IASB had a similarly effective FVA protocol and later, in 2011, it formally adopted the three-tier hierarchy (Ernst and Young, 2011; Journal of Accountancy, 2011). In FASB and IFRS documentation just before the GFC, directly observable inputs (Level 1 in the hierarchy) were the preferred option and were demanded whenever market data were available. This new technology emphasized mark-to-market accounting as a hard-line response to mark-to-model misuses. Ideologically speaking, this new incarnation would come to represent the high point of standard setters’ belief in using the market price mechanism to obtain accounting data. Observable market prices became the panacea to improve the relevance of financial asset values. In effect though, authorities had been lured into this by: their own fundamental belief in FVA itself; and the failure of mark-to-market FVA under Enron.

Not all commentators, however, thought that the solution to FVA problems was to enhance FVA more rigorously, or that the particular enhancements were well developed. While academic commentaries were slow to appear, some commentators from the profession attacked the new FVA regime. These complaints seem to be based on suspicions that failed mark-to-model elements still remained in the protocols and that the new mark-to-market elements were insufficiently tested. These commentators thought that the new regime had been, at best, rushed. Cataldo and McInnes (2007, p. 5) write:

Rather than allow needed debate, SFAS 157 seems to have been rushed into introduction in service of FASB's broader fair value ambitions. The Financial Executives International (FEI) Committee on Corporate Reporting, among the most engaged and assertive of participants in the U.S. accounting policy debate, in a letter dated March 16, 2006, called on FASB to re-expose the proposed standard. This came on the heels of a thoughtful and essentially critical assessment of the exposure draft by the AAA Financial Accounting Standards Committee (Accounting Horizons, July 2005). Previous to that, several companies submitted letters to FASB questioning and challenging most of the tenets of the exposure draft (e.g. Pfizer, Microsoft, Lockheed-Martin). Despite this criticism, FASB issued SFAS 157 on September 15, 2006 […].
These criticisms were not rigorously presented in any academic manner; it was more as if there was a general suspicion that any new version of FVA was just as likely to play into the hands of manipulators. During 2005-2008, commentators continued to question the FASB’s fair value program on these grounds, describing it as doctrinaire and unresponsive to criticism. Flegm (2005, p. 5) said that:

Through its standards, FASB gave the individuals behind these four major frauds – Enron, Qwest, Global Crossing, and Parmalat – the tools to defraud their stockholders. FASB is part of the problem when it should be part of the solution. Derivatives are extremely complicated to evaluate under the best circumstances, but when such assets are required to be written up to a presumed “market value”, or 30-year executory contracts are required to be discounted to present value, abuse is almost inevitable.

And:

FASB has turned a deaf ear to the real users of financial data on a day-to-day basis – that is, the owners and managers of a company who use the accounting data for controlling the operations of the company, for protecting the assets, for evaluating employees and granting pay raises or bonuses, for judging the success of a new product or advertising program, and so on (Flegm, 2006, p. 1).

Flegm’s conclusion is that “FASB pursues the fair value measurement base out of hubris” (2005, p. 6). Benston (2008, p. 104) asked of FAS 157: “Does the FASB really understand what it adopted?”

By 2008, whether from hubris, ideological advancement or practical necessity, the FASB and IASB had arrived at the Fair Value World View of Whittington (2008), a view held predominantly (if not universally) by board members and technical staff. Under this World View, FVA concentrates on serving capital market investors, seeks forward-looking accounting information, and focuses on future cash flows not specific to the entity. There is also an embedded assumption that capital markets are complete and competitive, in other words, perfectly accessible markets. The “Alternative View,” which might be depicted as a more traditional view, gives priority to existing shareholders and promotes stewardship. While forecasting of cash flows is also relevant, the alternative view assumes that investors’ valuation models will deal with information needs that are entity-specific, rather than generalized to markets. The alternative view assumes that imperfect markets are common or usual (Whittington, 2008, p. 160). Related to these dichotomous views is the continuing debate over the Decision Usefulness view vs the Stewardship view (Oldroyd and Miller, 2011), in which traditional stewardship functions are seen by some to have been either rendered less important or to have been subsumed in some way as a mere sub-set of decision usefulness. Related to this debate is the question of whether profits should be driven by shifts in balance sheet measurements over time, or whether this “balance sheet approach” (now favored by FASB/IASB) is too subject to uncertain measurements. FVA has become perhaps the classic example of the latter problem.

Ravenscroft and Williams (2009, p. 770) focus more on the ideological, neoliberal basis of the FVA protocols, with its fundamental belief in the “imaginary” power of market information:

[...] financial reporting has reached a state of near-total incoherence [...] a source of this incoherence is the transformation of the US accounting academy into a sub-discipline of financial economics, a transformation in which accounting became a servant of the imaginary world of neoclassical economics [...] we describe the displacement of accounting’s centuries-old root metaphor of accountability by the metaphor of information usefulness and situate that displacement within neoliberalism [...] The Financial Accounting Standards Board’s (FASB) attempts to make the imaginary world of neoclassical economics real have resulted in rules which are not defensible.

As a seeming culmination of this trend, the IASB, and FASB, in their revamp of the conceptual framework, are seeking to jettison much of the requirements of prudence and
reliability in favor of relevance. The move has been criticized by accounting professionals (Institute of Chartered Accountants in England and Wales, 2013).

During the 2000s, another group of critics led by Watts point out that conservative stewardship is ultimately more important to investors than earnings numbers (Basu, 1997; Bushman and Piotroski, 2006; Holthausen and Watts, 2001; Watts, 2003, 2006). To Watts (2006), conservatism represents the “long term political equilibrium” (p. 56) of financial reporting, and grand experiments with fair value have positioned standard setters dangerously. According to Watts, movements toward this equilibrium are driven largely by litigation against auditors and corporate managers who have overstated assets and profits. Given the size of litigation in the USA, accounting statements “are likely to continue to be conservative regardless of the standards introduced by the FASB” (FASB, 2006, p. 56). However, the production of these sentiments and temperature of discussion on fair net value, in the mid-2000s, was brought to an abrupt conclusion, and spun in a new direction, by the GFC.

In a spectacular piece of bad timing, the GFC arrived just after the newly implanted mark-to-market regime. By mid-2008, rising interest rates in the USA had caused a financial crisis in the wake of a collapsed housing bubble. Banks had been trading in “monetized” loan products, which had been bundled into complex tranches and on-sold to financial institutions around the world (McSweeney, 2009). When these assets began to fail, and to be written down, the banking industry and its supporters claimed that the immediate problem was the way they were being measured: that mark-to-market took a brutal, short-term view of tradable financial assets (American Banking Association, 2008; Institute of International Finance, 2008; International Banking Federation, 2008; Schor, 2008). After that, and all during the GFC, argument raged about the suitability of mark-to-market accounting. Some academics support the banks’ view that the short-term approach of mark-to-market is problematic (e.g. Allen and Carletti, 2008; Hellwig, 2009; Plantin et al., 2008); others do not (e.g. Amel-Zadeh and Meeks, 2013; Badertscher et al., 2012; Laux and Leuz, 2009).

Clearly shocked standard setters at first defended the mark-to-market protocol (Herz, 2008; Tweedie, 2008). After a US House of Representatives hearing in March 2009 (Congressional Hearing, 2009), in which standard setters were roundly criticized by US political leaders, the FASB capitulated by revising the standards such that mark-to-market (Level 1) did not need to be used when a market could be considered “inactive.” The guidelines were, though, broad and malleable: evidence of inactivity could include few recent transactions, price quotes that varied, and FVA prices that did not correlate with other indices (Financial Accounting Standards Board, 2008, 2009). The IASB made similar changes but went further, to allow the switching of FVA measured assets back to historical cost, a procedure that previously had not been allowed (International Accounting Standards Board, 2008a, b, c, d, 2009, paragraphs 50, 54).

After these changes, the FASB and IASB appeared to have been back to where they were in 2001: an FVA protocol that allowed liberal use of “management estimates.” Eight years later, in 2018, these FVA measurement protocols remain unchanged in basic principle. In the meantime, at least one major accounting crisis has showcased the misuse of FVA protocols. This was the Greek financial crisis, in which regulators (European Securities and Markets Authority, 2012) discovered significant under-reporting of losses and deliberate avoidance of Level 1 measurement, in order to misuse management estimates of Greek financial assets. In the wider sphere of financial assets, there are presently around $550 trillion of financial derivatives contracts with open positions, world-wide, measured at fair value (Bank of International Settlements, 2017, p. 1). These amounts are so astronomical that any measurement issues affecting these products are likely to have serious consequences. According to some commentators, mark-to-model measured derivatives hang over the world like the “sword of Damocles” (Hera, 2010) waiting for some trigger to cause another global crisis.
5. Conclusion
This paper argues that the response of standard setters and their supporters to the GFC can be seen as part of an FVA continuum, as summarized and depicted in Table III. FVA began as a piecemeal remedy for historical cost financial reporting problems of the 1990s. These problems had arisen in conjunction with the rise of financial asset trading, so a remedy based on FVA was thought to be timely and modern. This initial FVA (now called, colloquially, “mark-to-model” FVA), however, proved to be manipulable, with loose estimates and assumptions of future conditions. Enron and others manipulated mark-to-model FVA for their own corrupt purposes. A study of the Enron hearings of 2001-2002 shows that regulators, standard setters, professionals, and most commentators, in general, either did not understand sufficiently the consequences of FVA and how it was prone to manipulation, or, if they did understand it, chose to remain silent.

Later, in the mid-2000s, when more seemed to have been revealed about mark-to-model problems, the eventual response of standard setters was not to abandon the FVA experiment, but to supposedly toughen it with a new emphasis on “mark-to-market” accounting, which focuses on observable market transactions-of-the-moment. The latter element fitted nicely with a developing neoliberal attitude toward the supremacy and veracity of (rapidly changeable) market data, as transparent and useful information. Prudence and reliability, by contrast, and along with innate conservatism, seem to have been jettisoned as a consequence. But the new FVA scheme came with a “three level hierarchy” which still contained elements of the failed mark-to-model regime and, in any case, the reliability or efficacy of short term mark-to-market data had been insufficiently investigated or tested. Despite these criticisms, it seems that nothing could stop the rise of FVA as part of an accounting world view.

By the time the GFC arrived in 2008, standard setters were encumbered with an FVA ideological baggage. The response of standard setters to severe criticism of FVA was, first, to deny that mark-to-market FVA (their ideologically preferred option) was problematic when associated with illiquid markets; and second, when politically there was no other option, to fall back upon the already failed mark-to-model version of FVA; a situation that subsists nearly a decade later. Presumably, within standard setter ranks there must exist a denial of these issues, just as was the case when, back in 2001, standard setters denied there was any problem with Enron and FVA. The academic community remains divided on the efficacy of even the supposedly rigorous mark-to-market version of FVA, and some support the complaint that the short term approach of mark-to-market FVA is problematic. One could ask if any of the versions of FVA have been, or are likely to be, serviceable and if we should simply return to an historical cost model.

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Abstract

Purpose – The purpose of this paper is to examine whether Shell Nigeria’s Global Memorandum of Understanding (GMoU) promotes corporate-community accountability as a basis for fostering sustainable community development in the Niger Delta.

Design/methodology/approach – Shell Nigeria’s GMoU stand-alone reports were analysed through the lenses of accountability and transparency theoretical frameworks to explore the extent to which GMoU, as a corporate social responsibility (CSR) initiative, is dialogically embedded and practised. Meaning-oriented content analysis was deductively used to isolate pertinent themes and generate findings from the background theoretical literature.

Findings – The authors find that Shell discursively appropriates the meaning of accountability and transparency in a manner that allows it to maintain its social legitimacy and the asymmetric power relations between itself and host communities whilst restricting communities’ agency to hold it accountable. Shell does this by interpreting the notion of participation restrictively, selectively deploying the concept of transparency and accountability and subtly exerting excessive control over the GMoU. Thus, the GMoU’s potential to contribute to sustainable community development and positive corporate-community relation is unlikely tenable.

Originality/value – Accountability and transparency are core and critical to corporate-community relations and for achieving community development CSR objectives, but are often taken for granted or ignored in the CSR literature on the Niger Delta of Nigeria. This paper addresses this gap in the literature by using accountability and transparency lenses to unpack GMoU model and contribute to studies on CSR practices by oil multinational corporations (MNCs) in developing countries. Indeed, the use of these lenses to explore CSR process offers new insights as to why CSR practices have failed to contribute to sustainable community development despite increased community spending by oil MNCs.

Keywords Accountability/transparency, Corporate-community relations, CSR/GMoU, Engagement/dialogue, Niger Delta communities, Shell/SPDC

Paper type Research paper

1. Introduction

Corporations possess power to influence the social space (Davis, 1960). This has in part increased demand for accountability and social responsibility, especially in developing economies (Belal et al., 2013; Gray, 2006). It resonates with Davis (1960, 1967) and Gray (2000) who argue that the responsibility of a business should be commensurate with its power and so business should be held to account accordingly. In relation to this power-responsibility argument, there have been normative debates in the past four decades or so on whether the social responsibility of business is to meet the objective of profit
maximisation for capital providers (Friedman, 1970; Jensen, 2002), or to address society’s expectations (Dowling and Pfeffer, 1975) and the needs of multi-stakeholders (Donaldson and Preston, 1995; Freeman, 1984).

These debates have been articulated around the concept of corporate social responsibility (CSR) which has evolved into different areas of interests (Reich, 2008). According to the World Business Council for Sustainable Development (1999), CSR “is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large” (p. 3). Several corporations around the world (especially multinational corporations (MNCs)) have embraced CSR practices to varying degrees, whether instrumentally to secure social licence to operate (SLO) or as a strategic business practice (Frynas, 2005; Idemudia, 2014a, b; Slack, 2012). For example, as part of the business case for CSR, corporations find incentives to engage in stakeholder management. One of the approaches or instruments corporations use to manage their stakeholders, especially their host communities, is the Memorandum of Understanding (MoU). Corporations in the extractive industries heavily use MoUs as an instrument to maintain their relationship with host communities and foster communities’ participation in addressing corporate impacts on them (see Fidler and Hitch, 2007).

However, the participation of communities in negotiation and dialogue with the MNCs may have several shortcomings. Garvey and Newell (2005) and Newenham-Kahindi (2011), for example, argue that communities do not speak with one voice due to ambiguous and conflicting interests among them. Governments may also undermine the interest of the communities (Neu and Heincke, 2004) by creating corporate-community power imbalance in favour of MNCs (Webie, 2015), and accordingly restricting the available space within which the communities can contest their rights and responsibilities (Newell, 2005). In managing this problem through CSR practices, the MNCs tend to overwhelmingly focus on community development initiatives as a means of managing and responding to community grievances, as well as making them benefit from resource extraction (Eweje, 2007; Frynas, 2005; Idemudia, 2007a, 2011, 2014a, b; Idemudia and Ite, 2006; Ite, 2004, 2007). However, stakeholders’ increasing criticisms of corporations in the extractive industry over the impacts of corporate operations on stakeholders and society, and the perceived inability of CSR to deliver on its promise have engendered a call for a shift from CSR to corporate accountability in the industry (Lauwo and Otusanya, 2014; Utting, 2008). This is because whereas corporate focus on community development initiatives is important, it tends to occlude the equally important need to hold corporations accountable in developing economies, often marred by weak market and governance institutions (Amaeshi et al., 2016; Garvey and Newell, 2005; Newell, 2001).

Unfortunately, many of the extant studies on CSR in the Niger Delta of Nigeria have tended to focus on assessing the outcomes of CSR practices and less on the processes via which CSR seeks to contribute to community development (Idemudia, 2008). Hence, we are still unable to explain why, despite the increase in CSR spending and changes in oil MNCs’ CSR strategies, corporate-community relations remain conflictual (Idemudia, 2010a; Idemudia and Ite, 2006). Consequently, Idemudia (2008) argued that we need to move from a focus on CSR outcomes (questions of whether CSR is good or bad for community development) to a focus on CSR processes (e.g. questions of accountability, transparency, power relations, etc.), if we are to better understand how and why CSR is (un)able to contribute to community development (see Idemudia, 2014a).

Against this background, this paper critically examines Shell’s [1] Global Memorandum of Understanding (GMoU) in the Niger Delta via accountability and transparency theoretical frameworks. This is important as it helps to ascertain the extent to which GMoU, theoretically and practically, promotes corporate-community accountability necessary for
fostering sustainable community development in Nigeria’s Niger Delta. The paper continues with an overview of CSR in the Nigerian oil industry, explores the shifting from CSR discourse to corporate accountability before discussing corporate-community agreements in the extractive industry, as well as the emergence of the GMoU strategy in Shell’s community development efforts. It then proceeds to discuss the methodology, findings and conclusion.

2. An overview of CSR in the Nigerian oil industry

National CSR agenda is often a product of historical and cultural factors (Campbell, 2007; Matten and Moon, 2008), and it often continues to mature according to the prevailing economic and political priorities of the country (Idemudia and Ite, 2006). In Nigeria, the proactive pursuit of CSR initiatives and their implementation as a business strategy is a relatively new and an emerging practice. However, CSR practices appear to have taken a strong root in the Nigerian oil and gas industry (Amao, 2008; Idemudia and Ite, 2006; Ite 2004), given the increase in CSR budgets over time (Aaron, 2011; Akpan, 2006; Frynas, 2005; Idemudia and Ite, 2006; Ite, 2007). The prominence of CSR in the Nigerian oil industry stems from the fact that oil production remains core to the Nigerian economy and the negative social and environmental impacts associated with oil extraction are always at the centre of public scrutiny.

For instance, the environmental degradation, high poverty and the endemic nature of corporate-community conflict in the Niger Delta region where oil is mainly extracted bring the oil MNCs into public gaze and scrutiny. Consequently, oil MNCs have had to develop different non-market strategies – often driven by corporate self-interest, the avoidance of negative reputational consequences and the quest for unhindered oil extraction (Aaron, 2011; Frynas 2005) – to respond to both local and international stakeholders’ pressures (Akpan, 2006; Eweje, 2007) and secure SLO (Idemudia and Osayande, 2016). In contrast, however, Ite (2004, 2007) contends that the MNCs’ pursuit of CSR activities in the Niger Delta is not mainly due to the need to secure/maintain SLO, but also emanates from a commitment to foster community development in the region. Similarly, others have suggested that a key driver of CSR practices in the Niger Delta is the Nigerian Government’s failure to embark on community infrastructural development. This, according to many commentators, accounts for why the local communities in the region demand for and expect CSR contribution to community development (Akpan, 2006, 2008; Frynas, 2009; Ite, 2004).

Notwithstanding, Idemudia (2014b) argues that this claim is too simplistic as the drive for greater demand for oil MNCs’ CSR initiatives goes beyond governmental failure, because communities’ demand for CSR is also due to the nature of oil business, the close relationship between oil MNCs and the Nigerian Government and the fact that oil MNCs will leave once oil wells dry up. While Frynas (2005) and Ite (2004) suggest that the CSR initiatives of oil MNCs risk promoting governmental failure as the Nigerian Government abandons its developmental responsibility to host communities, findings from Idemudia (2014b) suggest that oil MNCs’ CSR efforts have little or no relationship with governmental community development efforts in the region. Hence, he concludes that the close relationship between oil MNCs and the Nigerian Government and the very nature of oil extraction tend to better explain why communities expect government-like functions from the companies. Essentially, rather than seeing CSR as a domain of shifting responsibility as Frynas (2005) and Ite (2004) suggest, Idemudia (2014b) suggests that CSR is a domain of stakeholder contestation with negative consequences for community development. From this perspective, it can be argued that oil MNCs have both been victims and benefactors of governmental failure in the Niger Delta (Idemudia, 2010b).

Nonetheless, the problems associated with doing business in Nigeria are well documented (see The Economist, 2002). Issues of ethnicity and associated ethnic conflicts, absence of efficient social, economic, political institutions and widespread corruption...
allegedly pose formidable challenges to business in Nigeria (see Idemudia, 2007a). Consequently, Amaeshi et al. (2016) and Ite (2004) argued that the enabling environment for CSR is either lacking or yet-to-be developed, and at best, ineffective. This makes CSR practice in the oil industry not only difficult, but also often poor in innovativeness to deal with the unique challenges. Shell’s attempts to clean up oil spills during Rukpokwu spill in Rivers State of Nigeria were stalled for months because of internal wrangling among communities over who should be awarded the contracts (Shell Petroleum Development Company of Nigeria (SPDC), 2003). Consequently, the delayed remediation led to more severe environmental degradation and communities’ economic loss, which could have been prevented via early clean-up of the spill. Hence, internal divisions within communities and the associated conflicts in the Niger Delta hinder good CSR practices and limit the positive impacts of CSR initiatives on community development.

Consequently, the debate on CSR practices in the Nigerian oil industry focuses on the relationship between CSR practices and community development. This is premised on the assumption that if oil MNCs can contribute to community development via CSR, it will help to address local grievances, improve community livelihood and promote positive corporate-community relations (Idemudia, 2010a). As such, a number of works have sought to either examine the most effective governance model for implementing CSR or focus on the extent to which CSR has promoted community development. For example, Idemudia (2009a) compares two types of corporate strategy (i.e. corporate-community foundation and in-house corporate-community investment models) adopted by different oil MNCs to contribute to community development and improve corporate legitimacy in the region. These models aim to help oil MNCs secure their SLO, promote positive stakeholder relationship and contribute to community development. He argued that whilst the corporate-community foundation model is partly community driven, mediated by development NGOs and allows decision making to be shared between the company and communities, the investment model is corporate driven and managed in-house by the company. Therefore, the corporate-community foundation model allows for better communication, improved opportunity to rebuild trust, and a more effective community engagement strategy compared to the in-house corporate-community investment model. Idemudia (2009a) thus concluded that given that two-way communication, trust and effective engagement are vital for community development, the corporate-community foundation is a likely better vehicle for oil MNCs to contribute to community development than the in-house corporate-community investment model.

Similarly, Idemudia (2014c) recently compared the GMoU with the other two models and suggested that the GMoU model and the corporate-community foundation model share some common similarities as both enable some form of community participation in the CSR initiatives. For example, whilst the in-house corporate-community investment model is largely a top-down approach to project design and implementation devoid of community input (Ite, 2004), the GMoU model, like the corporate-community foundation, claims to follow a bottom-up approach. However, Idemudia (2014c) cautioned that each of these models has strengths and weaknesses from a corporate perspective with real implications for stakeholder relationship.

Furthermore, there continues to remain disagreement about the extent to which the CSR initiatives of oil companies have contributed to community development in the region. For example, Akpan (2006, 2008) and Frynas (2005) both argued that the CSR initiatives of oil MNCs have failed to contribute to community development and in some instances have caused inter- and intra-community conflicts (see also Aaron, 2011, 2012). In contrast, Ite (2005, 2007) suggested that the MNCs’ CSR initiatives have actually contributed to community development in the region given the extent of governmental failure. According to him, oil MNCs have continually changed their CSR strategies for improved
responsiveness to their host communities. Yet, Lompo and Trani (2013) recently offered a nuanced perspective by arguing that while the CSR initiatives of oil MNCs have contributed to access to basic capabilities like water, electricity and shelter, they have also undermined human development.

Similarly, Renouard and Lado (2012) noted that the CSR activities of oil MNCs have somewhat contributed to the improvement of the material well-being of some of the people living close to oil production sites, accompanied by deteriorated inequalities or “relational capabilities”. This latter position seems to reaffirm the view that while the CSR initiatives of oil MNCs might address their affirmative duties (i.e. doing moral and social good), they fail to address their negative injunction duties (i.e. preventing harm and correcting injuries inflicted) (Idemudia, 2009b). This is consistent with other experiences from elsewhere captured in mainstream CSR discourse. Utting (2007), for example, noted that while CSR initiatives might contribute to the “hard” aspects of social development such as road and school construction or environmental protection, they often fail with regard to the “soft” aspects of development such as empowerment, social justice, fairness and equality (see also Utting and Marques, 2010). Hence, Renouard and Lado (2012) concluded that oil MNCs in the Niger Delta need to focus on addressing those exceptional aspects of inequalities for which they are partly responsible.

The foregoing debates have been particularly insightful in highlighting the strengths and limitations of CSR as a vehicle for furthering community development in weak institutional contexts. While Idemudia (2007b) points out that disjuncture in corporate-community worldviews undermines CSR ability to contribute to community development, Frynas (2005) shows how CSR initiatives of oil MNCs are constrained by structural factors that undermine their effectiveness. Similarly, Eweje (2007) attributes the failure of CSR to deliver development to lack of trust between oil MNCs and local communities and the mismatch between corporate CSR rhetoric and CSR practices. However, these works suffer from two major shortcomings. First, in examining the relationship between CSR and community development, most of these works (except Idemudia, 2010b, 2014b) tend to over-emphasise corporate responsibility without a commensurate attention to stakeholder reciprocal responsibility. Yet, the success or failure of CSR practices to contribute to community development largely depends on corporate responsibility and stakeholder reciprocal responsibility as CSR practices do not occur in a vacuum (Idemudia, 2008, 2010b). Second, since most analyses of CSR-community development relation in the Niger Delta tend to focus on outcomes associated with CSR initiatives and not on the processes via which CSR supposedly contribute to community development, the issue of corporate accountability and its implications for the ability of CSR initiatives to contribute to community development have been largely ignored. Indeed, Garvey and Newell (2005) noted that mainstream CSR discourse has often paid insufficient attention to the issue of corporate accountability, or the role of power vis-à-vis how the mechanisms of accountability and spaces of community participation in CSR initiatives work in practice. Yet, this is particularly problematic given that numerous studies have demonstrated that corporate accountability is necessary if corporations are to contribute to community development (see Newell, 2001, 2008; Utting, 2005, 2008). Consequently, to begin to address this gap, this paper seeks to explore the extent to which transparency and accountability as well as participation are embedded in Shell’s GMoU strategy for contributing to community development in its host communities.

3. Shifting from CSR discourse to corporate accountability
The disagreements over the extent to which CSR has been able to contribute to community development in the Niger Delta, as highlighted above, have led to the view that the idea of CSR has outlived its usefulness, and that it is time to explore other more useful concepts like...
corporate accountability. Freeman and Liedtka (1991), in particular, argued that the idea of social responsibility has failed to help create the expected good society, and it has become a hindrance to meaningful conversations about corporations and good life. Hence, it should be abandoned. Corporate accountability, in a managerial sense, refers to issues of disclosure, auditing and monitoring of business practices, which are also consistent with the traditional preoccupation about "how to keep power under control [...] how to prevent its abuse, how to subject it to certain procedures and rules of conduct" (Schedler, 1999, p. 13). It can be seen as "an emancipatory concept that can be used to explore the social relationship that exists between MNCs and their stakeholders with emphasis on external effects that relate to developing closer relationship and increasing transparency" (Odoeme, 2013, p. 747). Indeed, Utting and Marques (2010) note that "corporate accountability implies moving beyond ad hoc voluntary initiatives, top-down 'doing gooding' and very selective forms of stakeholder engagement. Instead it emphasises the need for mechanisms that oblige corporations to answer to various stakeholders, allow victims of corporate bad practices to channel grievances and seek redress, and entail consequences for companies that do not comply with agreed standards". Central to this understanding of accountability are the concepts of "answerability" and enforceability. While answerability refers to the obligation to provide account for one's actions or inaction, enforceability refers to the mechanisms for realizing answerability and sanctioning its non-fulfilment where necessary (Schedler, 1999). Consequently, Newell (2003) argued that while answerability has increased as more firms seek to validate their actions to a wide array of stakeholders affected by their activities via corporate reporting and disclosure, mechanisms of enforceability remain either weak or underdeveloped.

Importantly, accountability apparently "conveys an image of transparency and trustworthiness" (Bovens, 2007, p. 448) as transparency suggests the rendering of things visible. Gray (1992, p. 415), for example, argues that:

The development of accountability [...] increases the transparency of organisations. That is it increases the number of things that are made visible, increases the number of ways in which things are made visible, and, in doing so, encourages a greater openness.

Although corporations apparently project a transparent posture, critics allude to the opaqueness of corporate transparency (Garsten and de Montoya, 2008; Roberts, 2009). This is because accountability and transparency are inseparably interwoven (Bovens, 2007). Gray et al. (2014) construe accountability as responsibilities to undertake actions and provide account of such actions to those with the rights to know, and a process of holding actors responsible for their actions. Unerman and ODwyer (2006, p. 351) argue that accountability provides the "mechanisms through which all those affected by an organisation's actions can demand an account from the managers of that organisation regarding how and why the organisation has acted in the manner it has". A corporation's disclosure of their operational impacts on stakeholders is an essential element of accountability as Zadek (1998) argues for the increasing importance of corporations to not only alter their actions that affect stakeholders but also to report on the related social, ethical and environmental performance to enable stakeholders assess the extent to which the corporations have "listened" and responded to their expectations in practical terms.

However, accountability and transparency are two important concepts contemporary corporations appear to appropriate to lend credibility to their enthusiasm about CSR (Christian Aid, 2004) under different guises ranging from self-imposed responsible business principles to adopted external codes such as the Global Reporting Initiative. Hence, Gray (2001) argues that accountability is a simple but often misused concept, whilst Bovens (2007) suggests that it is generally appealing because it conveys a sense of transparency. Shearer (2002, p. 563) argues that accountability is an "intersubjective relationship whereby one is
obligated to demonstrate the reasonableness of one's actions to those to whom one is accountable”. Accordingly, these intersubjective relationships give these “others” in accountability relations with the companies the right to define the terms for judging the accountability outcome (Gray et al., 1997; Shearer, 2002). This is consistent with Sinclair’s (1995, p. 221) idea that accountability “presupposes agreement about what constitutes an acceptable performance […] (including) the language of justification”. Engagement is thus fundamental to the determination of acceptable performance or accountability outcome. It is therefore not surprising that accountability is equally construed as democratically embedded (Archef et al., 2011; Brown and Dillard, 2013a, b; Contrafatto et al., 2015; Gray et al., 2014). This suggests that the democratic nature of accountability is reflected in discourses relating to giving voices to the accountees. For example, Bovens argues that accountability transcends monologue, propaganda or a mere giving of information because it must entrench a mechanism for debate and engagement. However, Adams (2004) and Unerman and Bennett (2004) argue that engagement is not identical to accountability but facilitates a mechanism that promotes it. But as dialogue or engagement is embedded in power relations, meaningful engagement is doubtful when the engaging parties have power asymmetry (Archef et al., 2011; Dillard, 2011; Gray, 2000, 2001; Gray et al., 1997; Owen et al., 2001; Unerman and Bennett, 2004). Nevertheless, greater corporate-community engagement is advocated in the extractive industry to promote cordial corporate-community relationship (Gilberthorpe and Banks, 2012), because mutual understanding and trust are vital for peaceful and harmonious corporate-community relationships (Idemudia, 2014a). A truly managed CSR practice that promotes the voices and expectations of the communities will apparently sustain corporate SLO (Slack, 2012). Despite the apparent corporate-community power asymmetry, the Niger Delta communities and oil MNCs in Nigeria consider corporate-community engagement as a (potential) strategy for promoting responsible corporate behaviour and accountability (Egbon, 2014) given that accountability is equally construed as “informed relations of trust” (Dar, 2014, p. 133). An engagement that does not privilege the dominant voice will likely promote CSR practices that incorporate the expectations of beneficiaries negatively impacted by corporate operations. Such engagement is embedded in dialogic logic or action (see Bebbington et al., 2007; Contrafatto et al., 2015).

Engagement drawing on dialogic logic is not oblivious of differences in the worldviews of the various stakeholders but focuses on building informed consensus that obliterate the dominance of each stakeholder’s primordial position. As Bebbington et al. (2007, p. 364) argue, “both parties commit to a process whereby both expect to learn something of the worldview of the other, both address structural issues that constrain them and collectively they strive to create some better outcome”. This suggests that dialogic engagement seeks out and problematises the conflict situation with a view to cooperatively articulate feasible solutions that will not impose the primordial ideology of the dominant group (see Contrafatto et al., 2015). Consequently, Bebbington et al. (2007) argue that successful dialogue occurs within open (transparent) processes in which each dialoguing individual is accorded the rights to speak, be heard and be able to exercise agency. According to Bebbington et al. (2007, p. 372):

A focus on stakeholders and their participation in organizational processes may also reflect a more dialogic framing of accountability. This would have two elements to it: dialogic entitlements (for example, information and participation rights) and dialogic institutions (where views can be debated in robust fashion).

In this sense, accountability is about how relationships among multiple actors are negotiated, reproduced and reinforced to create a continually evolving “system of reciprocal rights and obligations” (Dixon et al. 2006, p. 407). While some scholars have focused on
either “upward” flow of accountability to “external” social agent via formal reporting, or “downward” flow of accountability to lower level institutions or groups, others have focused on lateral accountabilities to stakeholders that are situated inside organisational settings (Kemp et al., 2012). This is because in tracking the directionality of accountability, the concept can be seen as an expression of the complex interactions and mutual dependencies between an organisation and its multiple stakeholders (Lozano, 2004). Hence, Kemp et al. (2012) argued that this approach to accountability can open up discursive spaces that go beyond just verification and auditing, but towards engaging accountability’s dialogic potential for shared reflection and learning. As such, Garvey and Newell (2005) noted that one of the important elements of accountability within corporate-community relations is the corporation’s adopted approach for beneficiaries’ participation. Essentially, accountability and transparency encourage engagement, trust, giving of voices and information sharing, which are fundamental to cordial corporate-community relations. As such, Idemudia (2009a, b, p. 140) argued that “allowing for accountability and sustainability mechanisms in CSR projects is important in an environment like the Niger Delta where conflict is endemic”. Unfortunately, “processes of accountability continue to be obscured within scholarly debates about CSR in the extractive industries” (Kemp et al., 2012). In that regard, Kemp et al. (2012) suggested the need to shift from current conventional auditing culture referred to as “new accounting” towards strengthening operational-level knowledge about accountability as a basis for a better understanding of corporate social performance. This paper seeks to directly respond to this call within the context of the Niger Delta.

3.1 Corporate-community agreements and the extractive industry
It is evident that resource extraction can produce both negative and positive impacts on local communities (Basu et al., 2015; Kemp et al., 2011; Moffat and Zhang, 2014). However, the positive benefits of resource extraction for communities can easily be eroded by their negative social and environmental impacts, which have historically been the case in most developing countries (Basu et al., 2015). Corporate negative environmental impacts promote criticism from stakeholders and possibly corporate legitimacy crisis (see Botes and Samkin, 2013; Matilal and Höpfl, 2009). As such, O’Faircheallaigh (2013) contends that corporate-community agreements provide opportunities for local communities to shape the conditions of resource extraction on their land and therefore redistribute the balance of power that has traditionally served to undermine their rights and marginalise their developmental priorities. Indeed, company-community agreement is now widely considered to be a practical mechanism for recognising the rights, needs and priorities of local communities as key “stakeholders” that are impacted by resource extraction, for managing the impacts of resource extraction and ensuring that the benefits derived are widely shared (Keenan et al., 2016). In that regard, MoUs between local communities, corporations and government agencies are seen as useful mechanism through which the extractive industries (i.e. mining, oil and gas and forestry) can contribute to community development, meet regulatory requirements, define stakeholder expectations and mutual obligations and manage non-technical risks (Esteves and Barclay, 2011; Fidler and Hitch, 2007; Baynes et al., 2016). However, the challenge of negotiating and implementing agreement that potentially contributes to community development while also ensuring that risks and impacts associated with resource extraction are successfully managed remains problematic (Keenan et al., 2016).

Nevertheless, corporate-community agreements often take many names, structures and processes. For example, varying degrees of MoUs are articulated in the literature using various terminologies such as Community Development Agreement (CDA) (O’Faircheallaigh, 2013, 2015), Community Benefits Agreement (CBA) (Fidler and Hitch, 2007; O’Faircheallaigh, 2013), MoU (Leke et al., 2014; O’Faircheallaigh, 2015),
GMoU (Idemudia and Osayande, 2016) and Negotiated Environmental Agreement (NEA) (Noble and Birk, 2011). A review of the literature suggests that CDAs, CBAs and NEAs are partly backed by legal or quasi-legal frameworks and so are usually not only a voluntary corporate initiative (see O’Faircheallaigh, 2015). However, the distinction between the various forms of MoUs appears to be slippery, as only few works have paid particular attention to the differences. For instance, O’Faircheallaigh (2015) argued that CDAs range from legally binding contracts to voluntary MoUs. But many other studies on CDAs apparently take such distinction for granted except O’Faircheallaigh’s (2015) study that clearly stated that it focused on legally binding CDAs. At any rate, MoUs could also be contemplated among tiers of governments, which McCremon and Fanning (2010) conceptualised as formalised non-binding agreements between parties, which can also be ignored by the consenting parties. MoUs are not legally binding but based on mutual obligation. McCremon and Fanning (2010) articulated some critical success factors of MoU such as unambiguous mutual desire to cooperate, negotiated priorities, outcomes upon which to situate accountability, inclusivity and transfer of financial resources if part of the MoU. Thus, a good MoU stipulates the activities to be carried out and how expectations should be monitored. Integral to MoU signing is the recognition that the parties are partners and would assume leadership role vis-a-vis the MoU subject matter (Leke et al., 2014). However, it is important to recognise that MoUs are products of negotiation and bargaining between the consenting parties and can be prejudiced by unequal power relations (O’Faircheallaigh, 2013, 2015). As such, the core challenge confronting corporate-community MoUs is that they are often informed by the unequal power relationship that exists between corporations and communities, and thus the limited nature of enforceability mechanisms in such agreements (O’Faircheallaigh, 2013).

Nevertheless, the enforceability of MoU is often predicated on the assumption that corporations now need both legal licence and SLO (Lacey et al., 2012). Indeed, SLO “involves having the acceptance and approval (and perhaps support and consent) of local communities to operate” (Lacey et al., 2012, p. vi). Whereas MoUs or CDAs are formalised written agreements, an SLO is an informal, intangible and unwritten implicit licence (Owen and Kemp, 2013) that is slippery to monitor/measure (Lacey et al., 2012) as what constitutes it is less developed (Moffat and Zhang, 2014). Although SLO is an implicit licence, its absence supposedly produces untoward consequences for corporations especially in the form of a legitimacy crisis that can undermine business operations. SLO is apparently more complex to articulate than MoU in a corporate-community context as the community stakeholders give legitimacy to the latter whereas stakeholders extending beyond the local community give legitimacy to the former (see Esteves and Barclay, 2011; Lacey et al., 2012; Prno and Scott Slocombe, 2012).

An MoU portrays corporate commitment to community development in part, at least, to sustain corporate legitimacy. Consequently, MoU could be construed as a means to gain and/or sustain SLO because working with the communities to meet their expectations and avoid conflicts is central to the process of maintaining SLO (Lacey et al., 2012; Moffat and Zhang, 2014). MNCs are increasingly under pressure from stakeholders to demonstrate their SLO credential (O’Faircheallaigh, 2013), which makes SLO an integral part of stakeholders’ discourses in the extractive industry (O’Faircheallaigh, 2015). As such, it has been argued that corporations mostly use CSR initiatives to gain SLO (Prno and Scott Slocombe, 2012; Ruwhiu and Carter, 2016). Although GMoU, not SLO, is the emphasis of this study, an SLO is apparently strengthened by the adoption of (G)MoU in the Niger Delta context. However, as previously mentioned, an obvious weakness of corporate voluntary initiatives like the GMoU is the lack of mechanism to enforce performance (O’Faircheallaigh, 2015). This is particularly the case given that oil MNCs can use their discursive power to appropriate the meaning of SLO and accountability so as to claim reputational benefits while masking
the gaps between company and stakeholder expectations (Owen and Kemp, 2013). In contrast, in their study of a poor township in South Africa, McIntyre et al. (2015) found that poor communities believed that they have influence over the extension of SLO. Consequently, it is important to examine the process rather than just the outcome of corporate voluntary initiatives such as the GMoU.

The need to assess CSR process via accountability and transparency lens is due partly to corporate-community power asymmetry and the need to better understand its implication for company and stakeholder expectations. Power asymmetry in corporate-community relations and engagement favours corporations (Kemp et al., 2011; O’Faircheallaigh, 2013). Imbalance in power sharing between actors undermines equal sharing of decision making, authority and responsibility, thus engendering conflicts (Baynes et al., 2016). Good governance is one that devolves power to the community stakeholders to mitigate unequal power relations, to promote equitable control and decision making. According to Baynes et al. (2016, p. 169), “governance itself is more about the power to make, implement and enforce decisions, rather than just the formal arrangements about how decisions are supposed to be made”. Power, dialogue and participation are important in promoting mutual beneficial corporate-community relations and ensuring that CSR projects meet stakeholder expectations (Kemp et al., 2011). With mining companies usually perceived as undermining the voices of community stakeholders (Basu et al., 2015), granting communities voices in corporate matters affecting them engenders cooperation (Moffat and Zhang, 2014). Importantly, accountability-linked strategies such as continual communication, transparent information disclosure to communities and strong CDAs (or MoUs) have been inextricably linked to the strengthening of corporate legitimacy (see Moffat and Zhang, 2014; Owen and Kemp, 2013).

3.2 **Shell and community development: the emergence of GMoU strategy**

The nascent stage of CSR development in Nigeria has meant that CSR policies and practices are continually evolving, and as in most other countries, the CSR agenda that companies in Nigeria pursue depends heavily on how the corporation conceptualises and understands CSR (Idemudia, 2007a). Various corporations constantly seek to tailor their corporate strategy for meeting their CSR obligations to the demands of their business environment by seeking to improve upon shortcomings in previous strategies. A good example is Shell Petroleum Development Company of Nigeria’s (2003, 2004) CSR initiatives that have gradually evolved from mere Community Assistance (CA) in the 1960s, to Community Development (CD) in the 1990s and Sustainable Community Development (SCD) in 2004. According to SPDC (2004), this strategic transition from CA to SCD was in part an attempt by the corporation to respond to increasing community pressures for it to do more as well as improve the impact of its CD programmes on host communities. As such, Ite (2007) attributes the changes in Shell Petroleum Development Company of Nigeria’s (SPDC) CSR strategies to a combination of internal consideration and external pressures.

However, others such as Akpan (2006), Eweje (2007) and Idemudia (2010a, 2009b) attribute the changes to the fact that both the CA and CD strategies often lacked community input in the design and implementation of CSR, which meant that either CSR resources were misallocated or hijacked by a few community elites. Similarly, the poor implementation of CSR projects and their lack of sustainability was also another factor that drove the changes in Shell’s CSR strategy (Draper, 2010; Ite, 2007). Indeed, Ite (2007) suggested that a major problem with Shell’s CSR strategies, which also explains why they failed to produce the desired result, relates to the company’s tendency to take a partial rather than holistic approach to community development. To address these problems, Shell recently turned to corporate-NGO-community partnership called GMoU to contribute to community development in its host communities and secure its SLO (Idemudia and Osayande, 2016).
Unlike MoUs that are often an agreement between a particular community and a company, a GMoU is an agreement between Shell and a cluster of several communities identified based on local government area, ethnicity and historical affinities. Under the terms of the agreement, Shell provides funding for five years and the communities decide, plan and implement community development projects. In addition, Shell facilitates the capacity building of the GMoUs by providing access to development experts usually their NGO partners to oversee project implementation. The Community Development Board (CDB) is the core governance institution of the GMoU, and it is supposedly embedded in the participating communities via the community trust (CT). The CT consists of ten persons with at least three women who are usually resident in and trusted within the participating communities. From these ten CT members, each community provides three persons with at least one woman to establish the CDB. Hence, the CTs are responsible for ensuring that the GMoUs’ benefits reach their individual communities via effective representation of their respective communities at the CDB. The CDB is responsible for managing and coordinating the development activities of the GMoU across all the communities in a given cluster.

The CDB consists of all the chairpersons, secretaries and members of the CT, a representative of SPDC, local government, state government, The Niger Delta Development Commission, National Petroleum Investment Management Services and donor community. However, Alfred (2013) noted that with the exception of SPDC’s representatives, the other representatives appear to be uninterested. Nonetheless, each CDB has standing committees for finance and resources management, partnering, communication and capacity building, peace and conflict resolution and technical committees. Furthermore, the CDBs are entitled to a small percentage of the annual negotiated sum from the GMoU agreement to manage their administrative functions. Finally, the GMoU is underpinned by Operations Policy and Procedure Guidelines as the CDB becomes the only legitimate interlocutor recognised by SPDC in its engagement with its host communities. As at 2011, SPDC has signed and implemented agreements with 27 clusters that cover 290 communities (representing about 30 per cent of its host communities) and 9 of the 27 CDBs have grown to become registered foundations that receive third-party funding (Shell Companies in Nigeria (SCIN), 2013).

The GMoU initiative cuts across a wide range of areas such as economic empowerment, capacity building and improving the quality of life of host communities. In contrast to the various variants of MoUs in the mining sectors of Canada, Australia and Papua New Guinea articulated largely around socio-economic benefits and environmental impact mitigation, Shell’s GMoU does not contemplate addressing environmental concerns. However, in contrast to Shell’s CA or CD strategies that were largely top-down, the GMoU appears to be a bottom-up process that gives voice to communities and puts them in the driving seat of their own development. In addition, the model claims to be an instrument for effective community engagement based on transparency and accountability. However, Aaron (2012) argued that while the turn to GMoU by Shell in Nigeria is a radical departure from its previous CSR strategies, the GMoU is still being plagued by old challenges and as such has failed to deliver sustainable development benefits for the Niger Delta people. In contrast, Alfred (2013) commended the success of the GMoU so far. Indeed, based on a participatory stakeholder evaluation, Hohen et al. (2012) suggested that despite some weaknesses, the GMoU is contributing to community development in the region. For Idemudia and Osayande (2016), this disagreement is partly due to the difficulty of measuring the impact of CSR in the Niger Delta, yet it supports our view that debate over the relationship between CSR and development in the region tends to focus more on the developmental outcomes of CSR rather than the process through which CSR seeks to contribute to development. Consequently, our findings here will contribute to the extant literature on CSR and community development in two ways. First, it would deepen our understanding of CSR and community development relationship by addressing an aspect of the relationship that
has so far been under-explored within the context of the Niger Delta. Second, the findings presented here will complement extant works by identifying potential areas of corporate-community agreement that need to be strengthened if CSR initiatives are to deliver on their promise.

4. Research design

The data for this study are generated from Shell’s GMoU reports of 2010-2013, which included the first and most recent (as far as we are aware). The GMoU reports were obtained via the internet. Nonetheless, these reports are comparatively similar in content, except that while the 2010 documents referred to the GMoU as a signed agreement, the others called it a written statement. This change is immaterial and so does not merit any attention here. Corporations use various channels such as newsletter, annual reports, verbal, advertising and public relations brochure to communicate with their stakeholders (Buhr, 1998) with such reports apparently capturing management representation of reality (Bebbington, 1999). The GMoU document is a specialised stand-alone report published by Shell Companies in Nigeria and it is an important document as it focuses solely on Shell’s GMoU performance and process.

An interpretive or qualitative content analysis is used to analyse the GMoU texts according to themes that are drawn from the background theoretical review in this study. Belal and Momin (2009), Gray et al. (1995) and Tregidga et al. (2012), for example, highlighted the broad use of content analysis (primarily quantitative or form-oriented content analysis) in prior studies in social and environmental accountability research (SEAR), but Milne and Adler (1999) criticised the use of content analysis in SEAR in terms of the reliability of the coding instruments adopted in classifying corporate disclosures. However, Milne and Adler (1999) apparently focus on quantitative rather than qualitative content analysis. As content analysis can be employed as both quantitative and qualitative analytical methods, Smith and Taffler (2000), Merkl-Davies et al. (2011) and Vourvachis and Woodward (2015) distinguish between form-oriented (quantitative) and meaning-oriented (qualitative/interpretive/thematic) content analysis. Whilst the form variant focuses on counting of words or other concrete references, the meaning variant analyses themes embedded in the texts being investigated. The form-oriented content analysis has been dominant in SEAR.

Some scholars consider critical discourse analysis as a type of meaning-oriented content analysis (see Merkl-Davies et al., 2011; Vourvachis and Woodward, 2015). Meaning-oriented content analysis is also considered by some scholars as thematic analysis (see Marks and Yardley, 2004). Whilst Marks and Yardley (2004) suggest that thematic analysis (or meaning-oriented content analysis) could be deductive or inductive, Vourvachis and Woodward (2015) suggest that it could be deductive, abductive or inductive. Inductive content analysis suggests that the coding of themes is data driven and abductive content analysis suggests an iterative generation of coding themes by moving forward and backward between data and theoretical concepts. The deductive approach draws from existing theoretical ideas for the purpose of coding. According to Marks and Yardley (2004), such deductively derived themes allow for replicability, extension or refutation of prior discoveries. This study adopts this form of meaning-oriented content analysis, which Vourvachis and Woodward (2015) also refer to as semantic analysis and for which the coded categories must reflect the purpose of the research to give validity to the coding.

This study is guided by a coding guide involving issues of accountability and transparency, community participation, control and ownership of GMoU processes. Hence, we adopt Gill’s (2000) notion of “sceptical reading”, which implies searching for purpose lurking behind the ways something is said or represented. Indeed, Gill (1996) suggests treating the way something is said as being “a solution to a problem”, which
informed how we organised our analysis. To overcome potential bias, the authors compared notes afterwards and resolved any disagreements. Evidently, the narratives in the GMoU documents appear to communicate the responsiveness of Shell to stakeholders’ criticisms regarding its deficient process of sustainable community development initiatives[2]. Shell’s GMoU disclosures appear to focus attention on key issues on which it, and generally companies in the extractive industries, is/are criticised by stakeholders in resonance with Brennan et al.’s (2013) assertion that CSR communication is acute during periods of controversy or conflict.

5. GMoU through corporate accountability lens: analysis and discussion
For the purpose of this study, we particularly focus on three aspects of the GMoU processes that traditionally have been the basis of criticisms of Shell’s CSR initiatives in the Niger Delta, and which the new GMoU strategy supposedly addresses. These issues are community participation in their own development; accountability and transparency between Shell and its host communities and the control and ownership of GMoU processes to ensure project sustainability (see Akpan, 2006; Frynas, 2005; Idemudia, 2007b, 2009b; Ite, 2007).

5.1 GMoU as a participatory dialogic approach to community development
As the background literature suggests, one of the areas Shell and other oil companies in Nigeria have been criticised vis-à-vis their CSR initiatives involves their unilateral determination of community development projects, which are apparently different to communities’ priorities. Consequently, engagement and communication are essential to understanding the needs and priorities of the communities. Shell considers the GMoU as a veritable means of communicating and engaging with the communities by stating that:

They [GMoUs] encourage greater participation and create a more open and transparent way for SPDC to communicate with communities and help support social investment projects (Shell Companies in Nigeria (SCIN), 2010, p. 1).

Indeed, the GMoU is a departure from the unorganised MoUs with individual communities which appear to create divisions and mutual suspicions among communities. These organised GMoUs appear to reflect local concerns when the choice of community projects are decided and managed by the communities themselves. This might account for why Shell considers it a more robust approach claiming that:

This system [GMoU] replaces the previous approach whereby SPDC agreed to hundreds of separate development projects with individual communities and managed them directly and separately (SCIN, 2013, p. 1).

As such, in order to demonstrate the participatory nature of the GMoUs, Shell states that:

Under the terms of the GMoU, the communities decide the development they want while SPDC on behalf of its joint venture partners provide secure funding for five years ensuring that communities have stable and reliable finances as they undertake the implementation of their community development plan (Shell Companies in Nigeria (SCIN), 2011, p. 1).

While there is no doubt that the new GMoU strategy has opened some space for community participation that was lacking in Shell’s previous CSR strategy, there is a need to interpret such participation with caution given that corporate-community power asymmetry is often likely to sway corporate-community participatory dialogue towards corporate advantage (Kemp et al., 2011; O’Faircheallaigh, 2013). Besides, meaningful engagement takes place in a dialogic context where the view of a subset or dominant group is not subtly imposed on the other engaging stakeholders. This unfortunately seems not to be the case as Idemudia and Osayande (2016, p. 9) argue that “while the GMoU is supposedly a bottom-up participatory
approach to community development, there continue[s] to remain key structural constraints of the ability of communities to actively participate in their own development and in the governance of corporate-community relations. This is because the boundaries of community participation is set within a particular understanding of the process of development in which oil extraction is central and alternative meanings and pathways to development are foreclosed. In other words, community participation is restricted to how oil funds provided by Shell for community development are to be spent as opposed to the more substantive question of whether oil extraction should continue to be a basis for community development in the face of the negative externalities it has generated. For instance, Faleti (2004) noted that there is often significant anger within communities over environmental degradation associated with dredging, contamination, spills and salt water inflow that negatively impact local livelihoods; but these issues are not incorporated into the scope of the activities covered by the GMoU. The implication therefore is that GMoU promotes a particular form of community participation that is consistent with oil MNCs’ interest of continuing oil extraction in the region. Hence, it can be argued that while the GMoU does allow for community consultation, it does not yet foster substantive community participation in corporate-led community development initiatives.

5.2 Transparency and accountability between communities and oil MNC

A core driver of corporate-community conflicts in the Niger Delta is the lack of trust (Eweje, 2007; Idemudia, 2007b) and the mismanagement/ misappropriation of CSR funds meant for community development by a few. Consequently, an emphasis on transparency in the GMoU is particularly important in any efforts to rebuild trust between communities and Shell as well as ensure sustainable community development. Indeed, the extant literature has strongly linked effective engagement or participation to transparency and accountability. Thus, Shell highlights that:

> The GMoU represents an important shift in approach, placing emphasis on more transparent and accountable process, regular communication with grassroots, sustainability and conflict prevention (SCIN, 2010, 2011, p. 1).

It also ensures high levels of transparency, inclusiveness and accountability in managing development funds (SCIN, 2013, p. 1).

Shell Sustainability Report (2011, p. 1) also asserts that “we [Shell] believe transparency in our operations helps build trust”. However, we found that the emphasis on transparency and accountability in the GMoU reports was on the activities of, and amongst, the clusters of communities in GMoU, as opposed to the accountability and transparency between Shell and the clusters of communities. In other words, there was an absence of reference to corporate-community transparency and accountability. Hence, while the GMoU for good reasons emphasises issues of transparency and accountability in the activities of the clusters within the GMoU, questions of corporate-community accountability seemed to have been selectively ignored. This position is supported by the fact that in a recent effort to assess the impact of its GMoU, Shell narrowly and vaguely defined the criteria of transparency and accountability as follows:

> This refers to openness to public scrutiny, available, accessible and disclosed information on processes, activities and transactions, and periodic stewardship feedback. It implies the extent to which GMoU processes especially the institution is open to scrutiny and provides information on its activities to its stakeholders (Idemudia and Osayande, 2016).

The consequence is that while Shell systematically downplays the importance of its accountability obligations to communities and ignores the role of the lack of corporate accountability in corporate-community conflict, it invariably suggests that the lack of
transparency and accountability within local communities is responsible for problems associated with community development and corporate-community conflict. This is largely consistent with Gray’s (2001) assertion that accountability can be misplaced or misused. In other words, corporations might rhetorically appropriate accountability to maintain the dominant social ideology (see Garsten and de Montoya, 2008; Moneva et al., 2006; Stoney and Winstanley, 2001).

Despite the significant environmental impacts of the oil and gas MNCs in the Niger Delta of Nigeria (UNEP, 2011), we found that Shell’s GMoU reports are conspicuously silent on the environmental impacts of the corporation. This silence is an obvious lack of transparency and accountability in relation to environmental sustainability. However, it is not surprising that the GMoU fails to directly address the issue of environmental degradation, which resonates with Hassan and Kouhy’s (2015) recent argument that oil MNCs operating in the Niger Delta show weak commitments to environmental accountability. The implication here is that accountability and transparency seem to be interpreted in a very selective and restrictive manner by Shell such that it applies only to the relationship between the communities in a cluster, but not to the relationship between communities and Shell. This perhaps explains why despite increase in community development spending, corporate-community conflict continues to remain endemic. This is because as Idemudia (2009b) argues, no amount of roads, schools or hospitals constructed can compensate for or alleviate environmental degradation or its effects on local communities.

5.3 Governance, control and ownership of CSR initiatives
A major factor that undermined the ability of Shell’s previous CSR strategy to contribute to community development was lack of sense of ownership of CSR process and initiatives by host communities, which often resulted in the poor sustainability of CSR projects (Idemudia, 2009a, b; Ite, 2004, 2007). Indeed, Frynas (2005) and Ite (2004) suggested that this problem has resulted in the proliferation of a kind of “dependency mentality” among host communities that has led to more demands being made on oil MNCs. However, Idemudia (2014b) disputed this suggestion that a “dependency mentality” pervades local communities as empirical data showed that not only were communities aware of their reciprocal responsibility but also were willing to undertake such responsibility. Nonetheless, Idemudia (2009b) noted that because of lack of sense of ownership due to the absence of community control over CSR initiatives, communities often lacked both the capacity and interest to maintain such CSR projects as they were seen as Shell’s projects. Consequently, the turn to GMoU strategy potentially and partly addressed this problem. Indeed, SPDC notes that:

It [GMoU] brings those communities together with representatives of local and state governments, SPDC and non-profit organisations (development NGOs) in a decision-making committee. These committees – which are not controlled by SPDC – give communities greater control and ownership over their own development […] (SCIN, 2010, p. 1).

As such, Shell asserts that:

[…] GMoUs have engendered better ownership and a stronger sense of pride amongst communities as they are responsible for implementing their projects (SCIN, 2013, p. 1).

Similarly, the nature of inclusivity in the GMoU’s governance structure might suggest that communities are likely to be insulated from undue corporate influence. For example, the inclusion of NGOs as capacity builders and the expectation that other actors like NGOs and government representatives will be active within the GMoU should in principle allow communities to take control and ownership over the decision-making process concerning their own development. In addition, the GMoU’s governance structure appears to weaken accusation against Shell that its CSR creates an opportunistic tendency for community elites
to capture CSR benefits at the expense of their communities (see Idemudia, 2010a). With this approach, the community representatives know the amount of money that accrues to their communities and they also exercise control over how such monies are expended. For example, Shell asserts that:

SPDC provides the committee [...] with secure funding for five years, ensuring that the communities have stable and reliable finances as they undertake their work. [...] Communities identify their own needs, decide how to spend the money, and implement projects by themselves (SCIN, 2010, p. 1).

The significance of the above assertion stems from the fact that in Shell’s old CSR strategy, CSR projects were often either poorly implemented or not utilised as they were inconsistent with communities’ priorities (Akpan, 2006; Idemudia, 2009b). Hence, it suggests that the incidence of abandonment of CSR projects in communities will be unlikely. Importantly, this again is supported by the fact that communities are given voice to select their projects to match their allocated GMoU funds over a period of time. However, in practice, the extent to which communities exercise control over the GMoU remains debatable. First, as previously noted, while other actors like NGOs and government actors are expected to be full participants in the activities of the GMoU, in reality they are often not active. Similarly, communities have no say over which NGOs Shell nominates to facilitate their capacity building. For example, Shell’s and Daper’s claims below on the participation of independent development experts in the GMoU process are apparently contradictory:

SPDC also provides access to development experts to oversee project implementation and build the capacity of the CDBs to grow into functional community development foundations (SCIN, 2013, p. 1).

Weak local NGO capacity has led to NGO staff invariably following instructions from SPDC implementation staff. The NGOs are often unable to achieve an equal dialogue with SPDC [...] Any perceived opposition to SPDC’s interests is dismissed, and NGOs fear “losing their contract” if they fail to follow SPDC instructions (Draper, 2010, p. 72).

This implies that the countervailing force to Shell’s undue influence over the GMoU is absent in reality. Furthermore, the approval of funding to clusters/communities comes with a stringent but unpublicized conditionality. This undisclosed clause integral to the GMoU is called freedom-to-operate. We understood this through the interactions with some community members and two NGOs that assist Shell in the implementation of its GMoU initiative. This suggests that GMoU is embedded in power relations and ultimately serve as an instrument to further stifle communities’ power to undermine corporate interest. The implication is that communities’ actual control over GMoU is at best limited and not based on corporate-community accountability.

6. Conclusion and emerging issues

There are three main emerging issues. First, it seems that in principle, the GMoU embodies some of the critical success factors for an MOU as suggested by McCrimmon and Fanning (2010), but lacks other core success factors in practice. For example, inclusivity and transfer of funds that are key success factors seem to be recognised in the GMoU model. However, the GMoU seems to fall short in the areas of outcomes upon which to situate accountability, negotiated priorities and efforts to prevent the undue influence of Shell over the GMoU due to corporate-community unequal power relationship. Hence, while the GMoU is certainly an improvement over previous CSR strategies, it is still unlikely a panacea for issues related to sustainable community development in the Niger Delta.

Second, the GMoU is at present informed by a restrictive interpretation of participation, a selective application of transparency and accountability, and remains squarely under
the control of Shell. Hence, contrary to O’Faircheallaigh’s (2013) suggestion that corporate-community agreement allows for the redistribution of power between corporations and communities, the GMoU seems to consolidate power in the hands of Shell via a strategy of accommodation by legitimation (see Hamann and Acutt, 2003) that minimises corporate criticism as well as limits further demands that can be made on Shell. In other words, the changes that Shell has made to its CSR strategy allows the company to project an image of being responsive to the demands of external stakeholders without giving up control over its corporate-driven community development efforts. Indeed, while changes to its CSR strategies might be seen as an indirect form of answerability and the GMoU reports as a direct form, GMoU lacks any measure of enforceability which is a necessity if corporate-community accountability is to be meaningful. As such, the GMoU as a form of corporate-community agreement seems to confirm Garvey and Newell’s (2005) assertion that the mechanisms of enforceability remain either underdeveloped or, in this case, are selectively and deliberately ignored.

Third, for GMoU to fully realise its potential and ensure that increase in CSR spending leads to win-win outcomes for both communities and Shell, then Shell must deliberately promote upward, downward and lateral accountabilities of its GMoUs. This would require Shell to relinquish more control over the GMoU and accept that the absence of total corporate control comes with some risks as well as sustainable benefits. In other words, Shell needs to adopt what Schmitt (2010) described as “open strategizing”, suggesting an open approach to building stakeholder relation in which stakeholders are allowed to collaboratively navigate through a number of diverse and challenging socio-political and ecological issues without following a rigidly structured management plan. Indeed, Schmitt (2010) suggests that Shell successfully used this strategy to manage and implement the Camisea gas project in Peru within a difficult business environment.

Notes
1. Subsidiary of Royal/Dutch Shell in Nigeria
2. Soobaroyen and Mahadeo (2016), for example, find that companies in Mauritius change disclosures regarding their CSR practices as a reaction to local tensions and government policy in a manner to manage public impression. The uniqueness of Shell’s GMoU unlike the CSR context Soobaroyen and Mahadeo allude to is that it is a self-imposed CSR initiative with the rhetoric of promoting community involvement.

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Further reading


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Abstract

Purpose – The purpose of this paper is to examine the effects of self-efficacy, goal orientation and task complexity on audit judgement performance in correctly linking audit procedures to audit objectives and types of misstatements.

Design/methodology/approach – The authors conducted an experiment audit with 154 auditors from small and medium audit firms in Malaysia as participants. The experimental task required them to link audit procedures to audit objectives and types of misstatements.

Findings – For sample of auditors from small and medium audit firms in Malaysia, the authors found that learning goal orientation has a stronger effect on audit judgement performance than performance-approach and performance-avoidance goal orientations. Self-efficacy mediates the effect of goal orientation when an audit task is less complex compared to when the task is more complex.

Research limitations/implications – These results highlight the importance of social cognitive factors in explaining variations in audit judgement performance for audit judgement tasks with different levels of complexity.

Originality/value – The incorporation of individual psychological differences as explanatory variables in audit judgement studies may lead to a better understanding of auditors’ judgement and decision-making processes in small and medium audit firms located in developing economies.

Keywords Self-efficacy, Goal orientation, Social cognitive theory, Audit judgement performance, Financial misstatement

Paper type Research paper

1. Introduction

The quality of an auditor’s judgements determines the overall quality of an audit (Bonner and Lewis, 1990), and an auditor’s ability to make high-quality judgements and decisions across varying levels of task complexity may be affected by their personal characteristics (Financial Reporting Council, 2006 report; McKnight and Wright, 2011). However, only a few studies in the auditing literature, such as Pincus (1990), Becker (1997), Iskandar and Iselin (1999), Abdolmohammadi et al. (2004) and McKnight and Wright (2011) have considered the effects of individual psychological factors on audit judgement performance. Therefore, using an experimental audit judgement task, this study examined the effects of two personal characteristics of auditors (goal orientation and self-efficacy) on audit judgement performance. The study is based on social cognitive theory, which specifies factors for determining human actions that may be useful for understanding differences in the performance of individuals in different work settings (Bandura, 1986).

Goal orientation refers to the goals that individuals implicitly pursue while attaining performance outcomes or achievements (VandeWalle, 1997). From the social cognitive
perspective, goal orientation is a personality trait that may positively influence the performance of challenging tasks (Bandura, 1986). Individuals with high goal orientations are motivated to perform tasks for the sake of developing competence (Dweck and Leggett, 1988). The goal orientation of an individual varies either as high or low in learning, performance-approach or performance-avoidance. Self-efficacy represents a psychological construct identified as the central factor in self-regulatory mechanisms that govern human motivation and actions and represents an individual’s belief in his or her ability to succeed in specific situations and in a variety of settings (Bandura, 1986; Steele-Johnson et al., 2000; DeShon and Gillespie, 2005; Payne et al., 2007). The effects of self-efficacy on both the social and cognitive aspects of judgement in varying job scenarios have been acknowledged (Bandura, 1986); however, there is a lack of research that examines the effects of auditors’ self-efficacy on audit judgement performance.

While technical accounting knowledge and problem-solving ability are important determinants of judgement task performance (Tan and Libby, 1997), an auditor’s personality traits such as self-efficacy and goal orientation may, at the margin, differentiate levels of audit judgement performance. Consideration of the influence of these factors may help explain variations in audit judgements (Pincus, 1990; Iskandar and Iselin, 1999; Abdolmohammadi et al., 2004). This study also examined the effect of task complexity on audit judgement performance because previous research found that task complexity moderates the impact of self-efficacy on performance (e.g. Stajkovik and Luthans, 1998a) and auditors typically make judgements and decisions involving tasks with a variety of task complexity.

This study contributes to the auditing literature by investigating the effects of goal orientation and self-efficacy on audit judgement performance, focussing on these two psychological constructs for several reasons. First, although prior research has found that these constructs affect performance, whether these constructs affect auditors’ judgement performance remains uncertain due to the types of participants and the nature of the tasks used in prior research[1]. The vast majority of previous studies have used either students or employees who are not trained to make specialized decisions in the way that auditors are trained. As a result of auditors’ specialized education and job training, it is likely that they make decisions differently than others. Second, prior studies on the effects of goal orientation and self-efficacy have used simple tasks that do not require a great deal of technical knowledge and are not characterised by decision uncertainty (Ford et al., 1998; Chen et al., 2000; Phillips and Gully, 1997; VandeWalle et al., 1999, 2001). However, audit judgement and decision-making tasks are complex and more uncertain than the tasks investigated in previous studies. For example, when conducting an audit, auditors must assess risks and link these risks to possible misstatements, audit assertions and types of evidence. In addition, auditors generate hypotheses using audit evidence, and the evidence may indicate multiple plausible hypotheses. Auditors make judgements and decisions using criteria and decision accuracy measures that are usually ambiguous. Therefore, a contribution of this study is the examination of the relationship between these psychological factors and the quality of judgements where the participants are trained professional auditors in the decision context and the tasks are more complex than those used in prior research[2]. Prior research in accounting and auditing has not examined the effects of these psychological factors on judgement quality.

Using an experimental audit task with 154 auditors from small and medium audit firms in Malaysia as participants, the effects of self-efficacy, goal orientation and task complexity on audit judgement performance were examined[3]. It was found that both learning goal orientation and performance-approach goal orientation have positive associations with audit judgement performance and that performance-avoidance goal orientation has a negative association with judgement performance. It was also found that learning goal
orientation and performance-approach goal orientation are positively related to self-efficacy, while performance-avoidance goal orientation is negatively related to self-efficacy. Self-efficacy is significantly and positively related to audit judgement performance and mediates the relationship between goal orientation and audit judgement performance. These results demonstrate the role of social cognitive theory in audit judgements for which self-efficacy acts as a mediating variable.

Additionally, a significant interaction was found between self-efficacy and task complexity and audit judgement performance. The effects of the moderated mediation of self-efficacy (mediator) and task complexity (moderator) on the relationships between each dimension of goal orientation and audit judgement performance were investigated, and the results indicated that the mediating role of self-efficacy and its interaction with task complexity explained the direct effects of the three dimensions of goal orientation on audit judgement performance. Although the significance of goal orientation and self-efficacy for elevating audit judgement performance tends to be lower for more complex tasks than for less complex tasks, this evidence shows that a higher level of goal orientation and self-efficacy results in better audit judgement performance. This finding implies that auditors should possess enhanced levels of goal orientation and self-efficacy if they are to make high-quality audit judgements in real auditing environments involving complex tasks.

The next section discusses the conceptual framework of this study and develops the hypotheses. Then, a description of the research method, the analyses of the results and the conclusions of this research are presented.

2. Prior research and hypotheses development
Auditors make numerous judgements and decisions throughout an audit engagement. For example, while evaluating the efficiency and effectiveness of internal controls, auditors use judgement to assess control risks, to link risks to audit assertions, to select and perform appropriate tests and to report the results of their work. Individual psychological factors, such as personality traits and motivational factors, are expected to exert a significant influence on audit judgement performance (Abdolmohammadi and Shanteau, 1992; Libby and Luft, 1993). According to Libby and Luft (1993), an individual’s psychological characteristics interact with environmental and motivational factors, which in turn influence audit judgement performance. The interaction of environmental factor may change either the direct effect of the individual’s characteristics or the indirect effect of motivation on audit judgement performance.

2.1 Social cognitive theory
Bandura (1986) introduced social cognitive theory, which considers both the social origins of human thought (what individuals learn by being part of a society) and the cognitive processes of human motivation, attitudes (what individuals recognise as the influential contributions of thought processes) and actions (Stajkovic and Luthans, 1998b). An important assumption of social cognitive theory is that people possess certain cognitive capabilities that enable them to be active processors of information (Bandura, 1986). Social cognitive theory predicts that an individuals’ belief about their capabilities to perform a task motivates them to seek out or avoid the task and that the cognitive capabilities of individuals should reflect their accumulated knowledge (Bandura, 1986).

In the context of auditing, an auditor’s belief that he or she is capable of performing a task requires him or her to confidently possess the cognitive capabilities to perform the task. This belief in cognitive capabilities is known as self-efficacy. Self-efficacy is a motivational construct that influences an individual’s choice of activities, levels of achievement, persistence, and performance in a range of contexts. Self-efficacy represents an individual
factor that social cognitive theory suggests has an influence on judgement performance (Stajkovic and Luthans, 1998b).

Another important psychological construct that may affect judgement performance is goal orientation. Research has linked goal orientation to individual differences in the motivation to learn (Ford et al., 1998), academic performance (Chen et al., 2000; Phillips and Gully, 1997; VandeWalle et al., 2001), training performance (Brett and VandeWalle, 1999; Brown, 2001; Kozlowski et al., 2001), task performance (Steele-Johnson et al., 2000; Mangos and Steele-Johnson, 2001) and self-regulatory behaviours (Ford et al., 1998; VandeWalle et al., 1999).

In Figure 1, a conceptual model for audit judgement performance based on past conceptual reviews of audit judgement, decision-making and social psychology literature is presented. The model is comprised of audit judgement determinants (Libby and Luft, 1993), task complexity (Bonner, 1994), self-efficacy (Bandura, 1986, 1997; Gist and Mitchell, 1992) and goal orientation (Dweck, 1986; Dweck and Leggett, 1988; VandeWalle, 2001).

2.2 Hypothesis development

This section develops hypotheses for the direct effect of goal orientation on audit judgement performance, the mediation of self-efficacy on the effect of goal orientation on audit judgement performance, and the moderation of task complexity on the mediated effect of goal orientation on audit judgement performance.

2.2.1 Goal orientation. There are three types of goal orientation: learning goal orientation, performance-approach goal orientation and performance-avoidance goal orientation. High learning goal orientation individuals are motivated to perform tasks to develop competence (Dweck and Leggett, 1988). High performance-approach goal orientation individuals are motivated to perform tasks to demonstrate competence to others or to gain favourable judgements from others. High performance-avoidance goal orientation individuals tend to avoid difficult tasks to avoid negative perceptions from others for poor task performance (VandeWalle, 1997; VandeWalle et al., 2001). Each type of goal orientation affects task performance differently.

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**Figure 1.** Model of audit judgement performance
Individuals with high learning goal orientations should demonstrate better judgement performance because they are motivated to increase their level of competence in any given activity through greater learning effort, by acquiring new skills or by seeking more effective strategies when faced with difficult tasks (Dweck, 1986; Dweck and Leggett, 1988; Coad, 1999). Therefore, auditors with high learning goal orientations are more likely to emphasise the development of knowledge and the acquisition of new skills through formal education, professional training and on-the-job learning experiences. This acquisition of new knowledge and skills increases competency and improves audit judgements and decision-making; therefore, a positive relationship between learning goal orientation and audit judgement performance is expected:

H1a. There is a positive relationship between learning goal orientation and audit judgement performance.

Individuals with high performance-approach goal orientations focus on gaining competence, and this goal orientation motivates the individual’s cognitive processes to facilitate optimal task engagement (Elliot and Harackiewicz, 1996). However, unlike high-learning, goal-oriented individuals, who are interested in mastering tasks, individuals with high performance-approach goal orientations are interested in demonstrating positive judgement to others (Radosevich et al., 2004). Previous research has found that high performance-approach goal orientation is positively related to exam performance (Elliot and McGregor, 1999) and task performance (VandeWalle et al., 2001). Therefore, in this study, auditors with high performance-approach goal orientations were expected to demonstrate better audit judgement performance than auditors with low performance-approach goal orientations:

H1b. There is a positive relationship between performance-approach goal orientation and audit judgement performance.

High performance-avoidance goal orientation individuals tend to avoid tasks that are likely to fail or avoid situations in which they may perform poorly (Schmidt and Ford, 2003). They seek to avoid demonstrating incompetence and to avoid negative judgements from others. As a consequence, they sacrifice valuable learning opportunities that could increase their knowledge, skills and task performance (Dweck and Leggett, 1988). Prior research provides consistent evidence of a negative relationship between high performance-avoidance goal orientation and performance (Elliot and McGregor, 1999; VandeWalle et al., 2001; Porath and Bateman, 2006). Thus, auditors with high performance-avoidance goal orientations are likely to avoid challenges, uncertainties or high risks of failure during their decision-making processes, which can result in poorer judgement performance (Coad, 1999):

H1c. There is a negative relationship between performance-avoidance goal orientation and audit judgement performance.

2.2.2 Mediating effect of self-efficacy on audit judgement performance. Social cognitive theory explains that an individual’s level of job performance may be partly due to differences in self-efficacy. Highly self-efficacious individuals tend to exert sufficient effort, which, when well executed, produces successful outcomes (Stajkovic and Luthans, 1998b). Bandura (1997, p. 160) noted that “people avoid activities and environments they believe exceed their capabilities, but they readily undertake activities and pick social environments they judge themselves capable of handling”. Individuals with a higher level of self-efficacy are more likely to undertake challenging tasks, which affects their acquisition of skills and knowledge and improves subsequent task performance. Therefore, individuals with high self-efficacy are more likely to exert on-task effort and succeed in performing the task (Phillips and Gully, 1997). In an audit setting, exertion of sufficient effort, particularly
cognitive effort, is likely to result in better audit judgement performance. Thus, self-efficacy mediates the effects of goal orientation on audit judgement performance, although the nature of the mediation may differ depending on the type of goal orientation.

Studies in psychology and education provide evidence of how learning goal orientation increases the level of self-efficacy to improve task performance (Phillips and Gully, 1997; Steele-Johnson et al., 2000; VandeWalle et al., 2001; Seijts et al., 2004). This previous research found that learning goal orientation is positively related to self-efficacy (Phillips and Gully, 1997; Kozlowski et al., 2001; Bell and Kozlowski, 2002), meaning that the higher an individual's learning goal orientation, the more they believe that their abilities, knowledge and skills can be increased. The willingness of individuals to develop their skills and acquire new knowledge increases their self-efficacy to perform certain tasks and improves their performance of these tasks. Auditors with high learning goal orientations will seek greater challenges and be more confident in their ability to successfully meet these challenges and show high self-efficacy. High self-efficacy auditors will put in more effort, which in turn improves their task performance.

Auditors with high performance-approach goal orientations are more likely to develop the self-efficacy to perform better during audit tasks and to demonstrate their ability to others. These auditors increasingly believe in their own ability, i.e. high self-efficacy, which improves their confidence to perform these tasks well. In a similar manner, both learning goal orientation and performance-approach goal orientation are positively related to self-efficacy. By contrast, high performance-avoidance orientation individuals tend to avoid tasks that they are not competent to perform for fear of failure (Dweck and Leggett, 1988) and are unlikely to attempt or exert extra effort on difficult tasks. As a consequence, these individuals develop low self-efficacy and are likely to abandon their efforts prematurely or fail to complete difficult tasks. They view exerting substantial effort as ineffective, and changing their perceptions of their own ability as being an innate attribute is difficult (Schmidt and Ford, 2003).

To summarise, both high-learning goal orientation and high performance-approach goal orientation are expected to have positive impacts on self-efficacy, which in turn should lead to better audit judgement performance. In contrast, a high performance-avoidance goal orientation is expected to have a negative effect on self-efficacy, which in turn should lead to poor audit judgement performance. Thus, self-efficacy should have a mediating role on goal orientation and audit judgement performance:

H2. Self-efficacy mediates the relationship between goal orientation and audit judgement performance.

2.2.3 Moderating effect of task complexity on audit judgement performance. Gist and Mitchell (1992) indicated that an individual's belief in their own capability to perform may be moderated by the complexity of the task. A meta-analysis by Stajkovic and Luthans (1998a) found that task complexity moderates the impact of self-efficacy on performance. Individuals with high self-efficacy exert more effort and should therefore outperform individuals with low self-efficacy, particularly during simple tasks because these require fewer cognitive processing activities. For simple tasks, auditors with high self-efficacy are expected to make significantly better audit judgements than auditors with low self-efficacy because individuals with high self-efficacy exert more effort in identifying the proper cues and in processing these cues while performing an audit task. By contrast, individuals with low self-efficacy become preoccupied with evaluative concerns, which has a negative impact on their performance (Bandura and Wood, 1989).

When performing complex tasks, Wu et al. (2012, 2013) suggested that individuals with high self-efficacy exert more effort than individuals with low self-efficacy, which leads to
better performance. High self-efficacy individuals also perform better on complex tasks because of their willingness to search for task-relevant information (Seijts et al., 2004). In addition, individuals with high self-efficacy are more persistent, especially when dealing with difficult tasks, resulting in better performance compared to individuals with low self-efficacy (Wu et al., 2012, 2013), who are unwilling to search for task-relevant information (Seijts et al., 2004). However, for complex tasks, high self-efficacy individuals perform only slightly better than individuals with low self-efficacy because complex tasks require higher cognitive processing activities, which limits the performance gains for high self-efficacy individuals (Wood et al., 2000). This suggests that task complexity moderates the impact of self-efficacy on audit judgement performance. Thus, the positive influence of self-efficacy on audit judgement performance is expected to be stronger for simple tasks than for complex tasks:

\[ \text{H3. The positive influence of self-efficacy on audit judgement performance is stronger for simple tasks than for complex tasks.} \]

2.2.4 Moderated mediation effect of self-efficacy. The effects of self-efficacy as a mediator and task complexity as a moderator on audit judgement performance may occur simultaneously. This joint effect is referred to as a moderated mediation (Muller et al., 2005; Baron and Kenny, 1986). High learning goal orientation, high performance-approach goal orientation and low performance-avoidance goal orientation are expected to increase self-efficacy, which in turn increases audit judgement performance. However, the influence of self-efficacy on audit judgement performance is expected to vary according to the level of task complexity. Chen et al. (2001) focused on self-efficacy as a mediator using a moderated mediation analysis and found that self-efficacy mediates cognitive ability performance and conscientiousness performance relationships in a simple task environment but not in a complex task environment. The effect of the interaction of each dimension of goal orientation and task complexity on audit judgement performance is mediated differently through the motivational process of self-efficacy. Therefore, we propose the following hypothesis:

\[ \text{H4. The mediating effect of self-efficacy on the relationship between goal orientation (learning, performance approach and performance avoidance) and audit judgement performance is stronger for simple tasks than for complex tasks.} \]

3. Research method

3.1 Research design and instrument

A between-subjects $2 \times (3) \times (2)$ quasi-experimental design was used in this study. Task complexity was manipulated as high and low. Two measured independent variables were included: goal orientation (learning goal orientation, performance-approach goal orientation and performance-avoidance goal orientation) and self-efficacy (high and low). The dependent variable was the percentage of correct responses for the audit task that each participant completed. Gender and experience were included as control variables because prior research found these variables to be significantly related to audit judgement performance, in that females performed better than males during complex tasks compared to less complex tasks (Chung and Monroe, 2001). Furthermore, depending on the complexity of the task, more experienced auditors performed better than less experienced auditors (Abdolmohammadi and Wright, 1987; Chung and Monroe, 2000).

This study involved two experimental audit judgement tasks, and each participant performed one of the two tasks. For the less complex task (Experimental Task 1),
participants were presented with a list of seven audit objectives and eight audit procedures for the sales and cash receipts transaction cycle. Participants were asked to identify the appropriate audit objective for each audit procedure. Four procedures were tests of control, and four procedures were substantive tests of transactions. This task was a low complexity task because it required simple thinking involving limited information and used direct criteria without clear component complexity and coordinative complexity (Bonner, 1994; Wood, 1986). For the more complex task (Experimental Task 2), participants were given eight substantive tests for the sales and cash receipts transaction cycle and eight cases of misstatements of cash receipts and asked to identify the appropriate substantive test that would uncover each misstatement. Task 2 was more complex than Task 1 because it required participants to exert more cognitive effort. To identify the appropriate audit procedure for the different misstatement scenarios, participants were expected to utilise information, i.e. component complexity, and to employ multiple audit procedures, i.e. coordinative complexity, as suggested by Bonner (1994) and Wood (1986)[4],[5]. See Appendix 1 for the experimental tasks.

The experimental materials included instruments for measuring the different types of goal orientation and self-efficacy. The 12-item instrument developed by VandeWalle (1997, 2001) was used to measure goal orientation dimensions. The first dimension, learning goal orientation, measures willingness to take on challenges, develop abilities and acquire new skills. The second dimension, performance-approach goal orientation, measures motivation to gain positive judgements from others. The third dimension, performance-avoidance goal orientation, measures avoidance of negative judgement from others. This instrument was also used by Seijts et al. (2004) to examine the effects of goal orientation on task performance for complex tasks. The four-item instrument adapted from Kozlowski et al. (2001) and Bell and Kozlowski (2002) was used to measure self-efficacy. Questions to obtain demographic information about the participants were also included. Task complexity was coded as 0 for the less complex task and 1 for the more complex task. Gender was coded as 0 for females and 1 for males, and experience was the number of years of work experience each individual had as an auditor.

3.2 Participants and data collection procedures
A stratified random sample of 100 audit firms located in the Klang Valley (central/large cities in Selangor and Kuala Lumpur), Malaysia was selected for participation in this study. Firms in this geographical area represent about 70 per cent of the audit market in Malaysia. The sample was stratified based on audit firm size by excluding the Big 4 audit firms. Therefore, the sample was only comprised of small and medium size audit firms[6]. Partners or managers of the selected audit firms were contacted to determine whether they were willing to have audit staff at the middle and lower levels working in their firm participate in the study. Four to ten sets of the research instruments were sent to firms that expressed an interest in participating in the experiment. The materials were randomly allocated to the audit firms that agreed to participate in the study. In total, 600 sets of experimental materials were mailed to the contact persons of the selected audit firms. The contact persons distributed the research instruments to senior and junior auditors working in their firm. Participants were advised not to discuss the questions or answers with their colleagues and were assured of confidentiality. The audit staff mailed the completed instruments directly to the researchers. After two weeks, a reminder letter was sent to the contact person asking them to request that the participants return the completed instruments.

A total of 154 completed instruments were usable, representing a 26 per cent useable response rate. Participants were comprised of 87 audit assistants, 53 audit seniors and 14 audit supervisors. The majority of the participants were female (69 per cent), university
graduates (56 per cent) and 36 per cent had attained their professional qualification. Average audit experience was 2.76 years. Table I provides the demographic characteristics of the sample.

4. Results
4.1 Validation of constructs
Factor analysis was used to examine whether the goal orientation instrument differentiates the three types of goal orientation and whether self-efficacy has a single dimension. As shown in Table II (Panel A), the relatively high factor loadings indicate that the items converge with the relevant factor. Results of the factor analysis validated the three dimensions of goal orientation (learning, performance-approach and performance-avoidance) and that the self-efficacy scales load on a single factor.

The internal consistency of each item was assessed using Cronbach’s $\alpha$. A Cronbach’s $\alpha$ value of 0.80 or above implies adequate reliability (Nunnally, 1978). As shown in Panel B of Table II, except for the modest reliability of the performance-avoidance goal orientation measure, the coefficients compared favourably with the recommended $\alpha$. These results indicate that self-efficacy and each dimension of goal orientation have sufficient internal consistency.

4.2 Descriptive statistics and correlation analysis
Table III presents the mean values of the variables. The mean value of audit judgement performance was 53.81 per cent (SD = 15.04). The mean values of the three dimensions of goal orientation and self-efficacy were obtained by averaging the scores of the respective question items, which ranged from 1 to 7. The mean values of the overall sample show that the participants generally had a high level of learning goal orientation (mean = 6.16), a moderate level of performance-approach goal orientation (mean = 5.13) and a low level of performance-avoidance goal orientation (mean = 3.44). This indicates that the auditors in our sample have the willingness to learn characteristic, although they tend to demonstrate their competency to others. With respect to self-efficacy, the mean score of the participants was high (5.41).
Table III also reports the Pearson correlation coefficients. The correlations between the independent variables are relatively low. The results show positive bivariate relationships between learning goal orientation and audit judgement performance and between self-efficacy and audit judgement performance.

4.3 Hypotheses testing
A hierarchical regression analysis was conducted to test the hypotheses because of its ability to test the effects of mediation and moderation simultaneously (Muller et al., 2005; Baron and Kenny, 1986). The regression results presented in column (1) in Table IV show...
that learning goal orientation is significantly associated with audit judgement performance ($b = 3.64, p < 0.05$) after controlling for gender and experience. The performance-approach and the performance-avoidance goal orientations are marginally significantly related to audit judgement performance at $p < 0.10$. Therefore, $H1a-H1c$ are supported. The results suggest that learning goal orientation has a stronger influence on audit judgement performance than the performance-approach and performance-avoidance goal orientations. This suggests that auditors with high-learning goal orientations, i.e. those who are willing to learn new knowledge and develop necessary skills, perform better than those who merely want to prove to others their ability to perform.

### Table III. Means and correlation analysis

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>SD</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Audit judgement performance</td>
<td>53.81</td>
<td>15.04</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>2. Experience</td>
<td>2.76</td>
<td>2.97</td>
<td>0.19*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Learning GO</td>
<td>6.16</td>
<td>0.74</td>
<td>0.25***</td>
<td>0.14</td>
<td></td>
<td></td>
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<tr>
<td>4. Performance-approach GO</td>
<td>5.13</td>
<td>1.22</td>
<td>0.14</td>
<td>0.11</td>
<td>0.25**</td>
<td></td>
<td></td>
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<tr>
<td>5. Performance-avoidance GO</td>
<td>3.44</td>
<td>1.21</td>
<td>-0.10</td>
<td>-0.04</td>
<td>-0.16*</td>
<td>0.23**</td>
<td></td>
</tr>
<tr>
<td>6. Self-efficacy</td>
<td>5.41</td>
<td>0.95</td>
<td>0.34**</td>
<td>0.20*</td>
<td>0.49**</td>
<td>0.39**</td>
<td>-0.11</td>
</tr>
</tbody>
</table>

**Notes:** $n = 154$. *$p < 0.05$; **$p < 0.01$ (two-tailed)

### Table IV. Hierarchical regression analyses on audit judgement performance

<table>
<thead>
<tr>
<th>DV: AJP (1)</th>
<th>DV: AJP (2)</th>
<th>DV: AJP (3)</th>
<th>DV: Self-efficacy (4)</th>
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</thead>
<tbody>
<tr>
<td>$b$</td>
<td>SE</td>
<td>$b$</td>
<td>SE</td>
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<tr>
<td>Constant</td>
<td>50.87***</td>
<td>1.52</td>
<td>51.25***</td>
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<td><strong>Control variables</strong></td>
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<tr>
<td>Gender$^a$</td>
<td>5.64***</td>
<td>2.39</td>
<td>4.87**</td>
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<tr>
<td>Experience</td>
<td>1.86*</td>
<td>1.23</td>
<td>1.64*</td>
</tr>
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<td><strong>Main variables</strong></td>
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<td>Learning goal orientation (GO)</td>
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<tr>
<td>Performance-approach GO</td>
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<td>Performance-avoidance GO</td>
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<td>1.00</td>
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<td>Task complexity (TC)$^b$</td>
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<td>1.11</td>
<td>-3.87***</td>
</tr>
<tr>
<td><strong>Interaction</strong></td>
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<td></td>
<td></td>
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<tr>
<td>Learning GO × TC</td>
<td>0.79</td>
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<td>Performance-approach GO × TC</td>
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<td><strong>Mediator</strong></td>
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<tr>
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<td>2.56**</td>
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<td><strong>Interaction</strong></td>
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<tr>
<td>Self-efficacy × TC</td>
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<tr>
<td>$R^2$</td>
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<td>0.25</td>
<td>0.27</td>
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<td>Adjusted $R^2$</td>
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<td>0.21</td>
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<tr>
<td>Degree of freedom</td>
<td>144, 9</td>
<td>143, 10</td>
<td>142, 11</td>
</tr>
</tbody>
</table>

**Notes:** AJP = Audit judgement performance; GO = Goal orientation. $^a$Coded as 0 = female, 1 = male; $^b$Coded as 0 = less complex task, 1 = more complex task. *$p < 0.10$; **$p < 0.05$; ***$p < 0.01$ (two-tailed)
To test the mediation effect of self-efficacy proposed in H2, both the effect of goal orientation on self-efficacy and the effect of self-efficacy on audit judgement performance must be significant (Baron and Kenny, 1986; Muller et al., 2005). As depicted in column (4) in Table IV, both learning goal orientation and performance-approach goal orientation have positive relationships with self-efficacy ($b = 0.49, p < 0.01$ and $b = 0.25, p < 0.01$, respectively). Performance-avoidance goal orientation has a significant negative relationship with self-efficacy ($b = -0.11, p < 0.05$), indicating that a higher performance-avoidance goal orientation results in lower self-efficacy. Thus, the first condition for a mediation effect is satisfied. With respect to the second condition, as shown in column (2) in Table IV, self-efficacy is significantly related to audit judgement performance ($p < 0.05$). The positive coefficient ($b = 3.05$) indicates that auditors with high self-efficacy tend to perform better than those with low self-efficacy. These results indicate that self-efficacy mediates the positive effect of learning goal orientation and performance-approach goal orientation, as well as the negative effect of performance-avoidance goal orientation, on audit judgement performance. Therefore, H2 is supported.

In column (3) in Table IV, the interaction between self-efficacy and task complexity was added to the model. The results show the significant effect of the interaction between self-efficacy and task complexity on audit judgement performance ($p < 0.05$). The negative coefficient ($b = -2.95$) of the self-efficacy and task complexity interaction indicates that, for complex tasks, high self-efficacy leads to higher audit judgement performance but the effect is not as strong for simple tasks. Therefore, H3 is supported.

For the results to support the moderated mediation effect as hypothesised in H4, two conditions must be met (Baron and Kenny, 1986; Muller et al., 2005): the mediation effect of self-efficacy on the relationship between each of the three dimensions of goal orientation and audit judgement performance must be established; and the interaction between self-efficacy and task complexity must have a significant effect on audit judgement performance. Both conditions were satisfied because the results indicate that the effect of goal orientation on audit judgement performance is mediated by self-efficacy, and the effect of self-efficacy on audit judgement performance is moderated by task complexity. Therefore, the moderated mediation relationship between audit judgement performance and the three types of goal orientation, self-efficacy and task complexity as proposed in H4 is supported.

4.3.1 Additional analyses examining the effect of hierarchical position in the audit firm. Additional analyses were conducted (not tabulated) to examine whether hierarchical position in the audit firm is significantly associated with audit judgement performance by replacing experience with job position. An analysis was also conducted to determine whether the effect of goal-orientation on audit judgement performance depends on the auditor’s hierarchical position in the firm by including interaction terms between job position and each of the goal orientation variables. Job position is not significant and none of the interaction terms between goal orientation and job position is significant. Thus, the effect of goal orientation on audit judgement performance does not depend on the auditor’s hierarchical position in the audit firm.

4.4 Post-hoc analysis of self-efficacy
A post-hoc analysis was performed to address the role of knowledge in the relationship between self-efficacy and audit judgement performance. In general, it has been found that individuals with higher self-efficacy perform better than individuals with lower self-efficacy (e.g. Stajkovic and Luthans, 1998a). However, other factors may also affect audit judgement performance. Therefore, whether, under different levels of self-efficacy, audit judgement performance is affected by other individual factors, such as job position (representing knowledge) and gender, was also examined as suggested by Libby and Luft (1993).
Participants were classified as having high or low self-efficacy based on a median split of their self-efficacy score. Table V (Panel A) provides the means of the audit judgement performance for gender, job position, task complexity and self-efficacy. Panel B presents the results for the effects of gender, job position, task complexity and self-efficacy on audit judgement performance. Significant effects were found for each of the four variables on audit judgement performance (gender \( p = 0.016 \), job position \( p = 0.054 \), task complexity \( p = 0.001 \) and self-efficacy \( p = 0.025 \)). These results indicate that male respondents performed significantly better than female respondents. Supervisors demonstrated better performance for the audit judgement task than audit seniors or audit assistants, consistent with their higher levels of experience. Thus, gender, job position, task complexity and self-efficacy have significant effects on audit judgement performance.

The ANOVA results reported in Panel B of Table V indicate that the interaction between self-efficacy and task complexity has a significant effect on audit judgement performance \( p = 0.059 \). However, the interactions between self-efficacy and job position and between self-efficacy and gender are not significant. These results suggest that job position and gender have a significant and direct effect on audit judgement performance but do not moderate the effect of self-efficacy on audit judgement performance. Therefore, differences in audit judgement performance between auditors with high self-efficacy and those with low self-efficacy depend on task complexity. For the simple task, auditors with high self-efficacy performed significantly better than auditors with low self-efficacy. For the complex task, auditors with high self-efficacy performed slightly but not significantly better than auditors with low self-efficacy. This finding may be attributed to the fact that complex tasks demand

### Table V. Analysis of variance results

#### Panel A: Mean of audit performance

<table>
<thead>
<tr>
<th>Ind. variable</th>
<th>Category</th>
<th>( n )</th>
<th>Mean</th>
<th>SE</th>
<th>( F )</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender</td>
<td>Male</td>
<td>50</td>
<td>57.800</td>
<td>14.825</td>
<td>5.343**</td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>104</td>
<td>51.899</td>
<td>14.839</td>
<td></td>
</tr>
<tr>
<td>Job position</td>
<td>Audit assistant</td>
<td>87</td>
<td>53.247</td>
<td>15.865</td>
<td>3.294**</td>
</tr>
<tr>
<td></td>
<td>Audit seniors</td>
<td>53</td>
<td>52.217</td>
<td>12.467</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Audit supervisors</td>
<td>14</td>
<td>63.393</td>
<td>15.492</td>
<td></td>
</tr>
<tr>
<td>Task complexity</td>
<td>Less complex (simple)</td>
<td>77</td>
<td>57.630</td>
<td>15.596</td>
<td>10.519***</td>
</tr>
<tr>
<td></td>
<td>More complex (complex)</td>
<td>77</td>
<td>50.000</td>
<td>13.523</td>
<td></td>
</tr>
<tr>
<td>Self-efficacy</td>
<td>Low</td>
<td>79</td>
<td>49.525</td>
<td>13.792</td>
<td>14.338***</td>
</tr>
<tr>
<td></td>
<td>High</td>
<td>75</td>
<td>58.333</td>
<td>15.069</td>
<td></td>
</tr>
</tbody>
</table>

#### Panel B: Tests of between-subject effects

<table>
<thead>
<tr>
<th>Source</th>
<th>df</th>
<th>Mean square</th>
<th>( F )</th>
<th>Sig.</th>
<th>( \eta^2 )</th>
<th>Observed Power ( a )</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corrected model</td>
<td>9</td>
<td>936.73</td>
<td>5.149</td>
<td>0.000</td>
<td>0.243</td>
<td>0.999</td>
</tr>
<tr>
<td>Intercept</td>
<td>1</td>
<td>254,163.44</td>
<td>1,397.098</td>
<td>0.000</td>
<td>0.907</td>
<td>1.000</td>
</tr>
<tr>
<td>Gender</td>
<td>1</td>
<td>1,090.99</td>
<td>5.997</td>
<td>0.016</td>
<td>0.040</td>
<td>0.682</td>
</tr>
<tr>
<td>Job position</td>
<td>2</td>
<td>542.88</td>
<td>2.984</td>
<td>0.054</td>
<td>0.040</td>
<td>0.572</td>
</tr>
<tr>
<td>Task complexity</td>
<td>1</td>
<td>2,158.34</td>
<td>11.864</td>
<td>0.001</td>
<td>0.076</td>
<td>0.928</td>
</tr>
<tr>
<td>Self-efficacy (high vs low)( a )</td>
<td>1</td>
<td>935.96</td>
<td>5.145</td>
<td>0.025</td>
<td>0.034</td>
<td>0.615</td>
</tr>
<tr>
<td>Gender × Self-efficacy</td>
<td>1</td>
<td>7.67</td>
<td>0.042</td>
<td>0.838</td>
<td>0.000</td>
<td>0.055</td>
</tr>
<tr>
<td>Job position × Self-efficacy</td>
<td>2</td>
<td>251.15</td>
<td>1.381</td>
<td>0.255</td>
<td>0.019</td>
<td>0.293</td>
</tr>
<tr>
<td>Task complexity × Self-efficacy</td>
<td>1</td>
<td>658.80</td>
<td>3.621</td>
<td>0.059</td>
<td>0.025</td>
<td>0.472</td>
</tr>
<tr>
<td>Error</td>
<td>144</td>
<td>181.92</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>154</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corrected total</td>
<td>153</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: *Low self-efficacy and high self-efficacy classifications are based on a median split of the participants’ self-efficacy score; \( R^2 = 0.243 \) (Adjusted \( R^2 = 0.196 \)). *\( p < 0.10 \); **\( p < 0.05 \); ***\( p < 0.01 \) (two-tailed)
greater behaviour and information processing to capture more multifaceted constructs (Chen et al., 2001). Figure 2 shows a graphical presentation of the interaction effect between task complexity and self-efficacy.

An additional analysis with tabulation was conducted by adding the following interactions to the ANOVA model reported in Table V: Gender × job position, gender × task complexity and job position × task complexity. These interactions were not significant, and inclusion of these additional interactions did not affect the significance reported in Table V. This additional analysis indicates that the effect of gender on audit judgement performance is not different between the different levels of task complexity or job position and that the effect of task complexity on audit judgement performance does not depend on job position.

5. Conclusion
Using an experimental audit task with 154 auditors from small and medium audit firms in Malaysia as participants, the effects of task complexity and two personality variables (self-efficacy and goal orientation) on audit judgement performance were examined. The results show that auditors with high learning goal orientations, i.e. a positive attitude towards learning new knowledge and developing new skills, performed better on audit judgement tasks than auditors with low learning goal orientations. Similarly, auditors with high performance-approach goal orientations exhibited significantly better audit judgement performance, although to a lesser extent than those with a high learning goal orientation. By contrast, performance-avoidance goal orientation had a negative effect on audit judgement performance. These results show that both high learning and performance-approach goal orientations increase the self-efficacy of auditors, which in turn leads to better audit judgement performance. A high performance-avoidance goal orientation does not increase auditors’ self-efficacy or improve audit judgement performance.

![Figure 2. Graphical representation of the moderating effect of task complexity on the relation between self-efficacy and audit judgement performance.](image-url)
Instead, auditors with low performance-avoidance goal orientations performed better than auditors with high performance-avoidance goal orientations. Task complexity moderates the effects of self-efficacy on task performance, indicating that the positive relationship between self-efficacy and audit judgement performance is stronger for simple tasks than for complex tasks.

Overall, the results suggest that different dimensions of goal orientation affect audit judgement performance differently. An auditor with a high learning goal orientation develops high self-efficacy and is more likely to perform well during audit judgement tasks. However, this positive effect of learning goal orientation through self-efficacy was observed only in the simple audit judgement task of this study. A similar result was not observed for the complex audit judgement task. Therefore, the effects of self-efficacy on audit judgement performance are affected by the degree of task complexity. These findings highlight the fact that personality characteristics and motivational factors have the potential to affect decision outcomes.

The post-hoc analysis strengthens the finding that there is a significant positive relationship between self-efficacy and audit judgement performance, which depends on the level of task complexity. Auditors with high self-efficacy are more confident and are likely to exert more effort to search for sufficient and appropriate evidence to substantiate audit judgements and decisions. Conversely, auditors with low self-efficacy are more likely to cease their efforts prematurely and complete the task with lower quality judgements.

The moderating and mediating roles of self-efficacy discussed above are consistent with social cognitive theory, which suggests that motivations and actions of individuals are largely regulated by their cognitive capabilities that enable them to be active processors of information (Bandura, 1986). The results of the current research are consistent with the social cognitive theory prediction that the behaviours of individuals are influenced by personal characteristics, which, in this case, were self-efficacy and the work environment.

It would be beneficial for audit managers and partners to be aware of how auditors with different types of goal orientations may perceive their own abilities and how this perception may affect their judgement performance. Individuals with high learning goal orientations are more persistent, exert more effort and engage in solution-based self-instruction. An awareness of the effects of these personality characteristics on audit judgement performance will enable audit partners and managers to incorporate appropriate approaches when recruiting staff and designing training programmes for staff development. For example, studies have shown that some training methods can enhance self-efficacy (Gist, 1989; Gist et al., 1989; Zimmerman et al., 1996; Mathisen and Bronnick, 2009) and that, when self-efficacy is enhanced, performance subsequently increases (Gist, 1989; Gist et al., 1989). Therefore, audit firms could employ training methods to improve self-efficacy and judgement performance.

This study has several limitations. First, the use of audit cases in an experimental setting may limit the generalisability of results because such cases may not reflect the complex specifics of the audit field (Bonner and Lewis, 1990). Second, the cases used in this experiment may not be as realistic as actual audit tasks. This is a well-known limitation of experimental studies. However, a validation was performed to ensure the suitability of the case materials. Third, it could not be guaranteed that the participants were randomly allocated to the high and low task complexity groups. The materials were randomly allocated to the audit firms that agreed to participate in the study. However, a contact in the firm distributed the materials to the actual participants and there was no guarantee that the contact did this in a random manner. Fourth, the study did not directly incorporate auditors’ task-specific knowledge in the model, as discussed in previous studies (Bonner, 1994; Libby and Luft, 1993), or other factors in the work environment that might affect learning and audit judgement performance. Fifth, the participants were from small and medium audit
firms in Malaysia; thus, it is unclear whether these results are generalisable to auditors working in large audit firms or auditors from other countries. However, there are no known theoretical reasons why the effects of goal orientation and self-efficacy on judgement performance would be dependent on country or audit firm size. Prior research that examined the effect of self-efficacy or goal orientation on task performance using Malaysian participants found that self-efficacy has a positive relationship with task performance, which is consistent with studies conducted in other countries (Mohd-Kosnin, 2007; Shah et al., 2011; Barkur et al., 2013; Che-Ha et al., 2014; Hii and Ahmad, 2015; Thien and Ong, 2015). With respect to audit firm size, although larger audit firms may hire graduates with higher self-efficacy and learning goal orientations because graduates with these traits are likely to be the better performers at university, there is no theoretical reason that the relationship between judgement performance, self-efficacy and goal orientation would be affected by audit firm size.

The study results provide a basis for the development of a more comprehensive theoretical framework for future audit judgement research. The incorporation of individual psychological factors as explanatory variables in audit judgement studies may lead to better understanding of auditors’ judgement and decision-making processes. Additional research is necessary to further understand how goal orientation and self-efficacy affect audit judgement performance using different audit tasks with varying degrees of complexity. Further research is necessary to learn more about how self-efficacy and other self-perception factors mediate or moderate the relationships between individual characteristics and environmental factors in audit judgement performance. In addition, similar research could be conducted in countries other than Malaysia, using auditors from large audit firms to determine how generalisable these results are.

Notes
1. For example, many studies have examined the effects of goal orientation on performance outcomes. Most of these studies are in the context of continual learning and focussed on academic performance (Dweck and Leggett, 1988; Button et al., 1996), task performance (Ford et al., 1998) and training (Ford et al., 1998; Phillips and Gully, 1997).
2. The level of task complexity varies based on the hierarchical position of the auditor. Senior auditors, such as managers and partners, undertake more complex tasks, such as risk assessments and engagement planning, than junior auditors, who tend to undertake tasks that are relatively less complex in nature. However, perceived task complexity is relative to experience and other factors, such as cognitive ability. Some of the more routine tasks undertaken by junior auditors are still complex from their perspective due to lack of experience and are more complex than the tasks typically examined in the psychology and education literature. This experiment used tasks that auditors at all levels would have received training for and would have performed during their work experience.
3. There is no theoretical reason for selecting auditors from Malaysia and there is no theoretical reason to believe that our results would differ if the study were conducted in another country. Malaysian auditors must comply with the Malaysian Approved Standards on Auditing issued by the Malaysian Institute of Accountants, which are based on the International Audit Standards published by the International Federation of Accountants. Malaysia has an audit inspection programme in which audits are monitored by the Malaysian Audit Oversight Board (AOB), a regulated agency under the Security Commission of Malaysia. Malaysia is a member of the International Forum of Independent Audit Regulators. Other member countries include the USA, Australia, Canada, UK, New Zealand, Japan among others. With respect to self-efficacy and goal orientation, previous research using Malaysian participants that examined the effect of self-efficacy or goal orientation on task performance for a variety of non-accounting tasks reported similar results to studies conducted in other countries (e.g. Che-Ha et al., 2014; Hii and Ahmad, 2015; Thien and Ong, 2015).
4. Participants would have received education and training for these tasks as part of university auditing or audit induction courses before they joined an audit firm. These topics are also covered in professional exams. In addition, auditors at the middle and lower levels of the audit firm hierarchy would have performed such tasks for actual audit engagements.

5. After completing the audit tasks, participants answered three manipulation check questions regarding the level of task complexity. Results of t-tests indicated that the participants perceived the less complex task as significantly less complex than the more complex task (all p-values < 0.03). In addition, the mean value of the audit judgment performance for the less complex task group was significantly higher than the more complex task (p < 0.01). These results confirm that the manipulation of task complexity was successful.

6. Audit structure may affect audit judgment performance (Cushing and Loebbecke, 1986; Bamber and Snowball, 1988). Big 4 audit firms are structured differently than non-Big 4 audit firms with smaller audit firms typically being less structured than Big 4 audit firms. The fact that this sample only included auditors from small and medium accounting firms reduced the likelihood that audit firm structure may have affected the results.

7. The goal orientation scores in this study are consistent with those in previous studies (e.g. Bell and Kozlowski, 2002; Gully et al., 2003; VandeWalle et al., 1999). The mean values for each of the three dimensions of goal orientation are not significantly different between the two task complexity groups.

References


**Further reading**


**Appendix**

Task 1: Identification of audit objectives for sales and cash transaction audit procedures.

Panel A: Audit objectives:
- Accuracy, Existence, Completeness, Classification, Authorisation, Posting, and Summarisation:

Panel B: Audit procedure
(Tests of control or substantive test of transactions):
- Compare the quantity and description of items on duplicate sale invoices with related shipping documents.
- Trace a sample of duplicate sale invoices to related shipping documents filed in the shipping department to make sure shipment was made.
- Examine duplicate sale invoices for an indication that unit-selling prices were compared with the approved price list.
- Perform proof of cash receipts.
- Examine duplicate sale invoices to determine whether the account classification for sales was included on the document.
• Trace a sample of remittance advices or prelisting of cash to cash receipts journal.
• Examine the sales journal for notes receivable and other unusual items.
• Examine a sample of remittance advices for approval of cash discounts.

Task 2: Identification of substantive tests for misstatements of cash receipts.

Substantive test of transaction:
• Compare dates of deposits with dates in the cash receipts journal and prelisting of cash receipts.
• Trace from the cash receipts journal to the bank statement.
• Trace selected entries from the cash receipts journal to entries in the accounts receivable master file.
• Examine documents supporting cash receipts for proper classification.
• Trace remittance advices or a prelisting of cash to the cash receipts journal.
• Trace selected credits from the accounts receivable master file to the cash receipts journal.
• Compare the prelisting of cash receipts with the duplicate deposit slip.
• Examine remittance advices and sales invoice to determine whether discounts allowed are consistent with company policy.

Misstatements:
• Cash receipt was wrongly added by RM1,500 because of a key entry mistake.
• Cash received on accounts receivable that had been prelisted by the secretary was stolen by the bookkeeper, who recorded the cash receipts and accounts receivable. The bookkeeper did not record the transactions.
• The data processing clerk made a transposition error (recorded a cash receipt as RM4,621 rather than RM6,421).
• Cash was prelisted and correctly input to the computerised accounting records, but the bank credited the wrong amount to the company’s bank account.
• One of the customers was given a cash discount higher than the approved discount rate.
• The receptionist unintentionally failed to give the accountant two remittance advices for which the cash had been prelisted.
• The accountant recorded the cash received at the correct amount, but credited the wrong customer’s account.
• Cash received from the sales of fixed assets was credited to the sales of manufacturing products.

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The role of local accounting standard setters in institutional complexity

“Explosion” of local standards in Japan

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Takahiro Endo
Kobe Daigaku Keizai Keiei Kenkyujo, Kobe, Japan

Abstract

Purpose – The purpose of this paper is to locate the role of local standard setters in institutional complexity, where multiple sources of pressure for change and continuity coexist. The existing research does not fully explore this since it tends to illustrate the way in which a particular interpretation concerning certain accounting standards prevails over time (Archel et al., 2011; Murphy and O’Connell, 2013; Pelger, 2016; Young, 2014).

Design/methodology/approach – It empirically examines and critiques the Japanese experience through the concepts of institutional complexity and translation that specify the relationship between the name and types of practice of accounting standards in the local context (Czarniawska and Sevón, 1996, 2005; Erlingsdóttir and Lindberg, 2005; Røvik, 2016; Sahlin and Wedlin, 2008). Data sources are texts produced (between 2001 and 2015) by the local accounting standard setter and relevant organisations that represent firms, the certified public accountants and regulatory agency, respectively.

Findings – The local accounting standard setter in Japan was exposed to competing pressures between change and maintenance, which was translated by the standard setter in Japan. Consequently, the translation led to an “explosion” of local accounting standards (“pure” International Financial Reporting Standards (IFRS), Japanese Generally Accepted Accounting Principles (GAAP), modified IFRS and US GAAP).

Originality/value – This paper is the first attempt to systematically examine the role of a local standard setter under institutional complexity. It illustrates how institutional complexity is turned into divergent outcomes against the assumption of previous research that indicates multiple interpretations of particular accounting standards finally merging into a specific one.

Keywords IFRS, Translation, Institutional perspective, Local standard setter

Paper type Research paper

Introduction

International Financial Reporting Standards (IFRS) has been adopted in many countries (Cascino and Gassen, 2015). However, the degree of adoption has varied to a great extent (Nobes, 2015; Nobes and Zeff, 2016; Tsunogaya et al., 2015; van Mourik and Katsuo, 2014; Walker, 2010). That is, some major economies including the USA, China, Japan and Switzerland have not required mandatory adoption. Furthermore, many countries have carved out specific elements of IFRS. Yet, such variation concerning the status of accounting standards across the countries has not been fully examined in relation to the role of local accounting standard setters.

Previous research has not entirely ignored the role of local accounting standard setters (Archel et al., 2011; Hassan, 2008; Irvine, 2008; Mir and Rahaman, 2005; Murphy and O’Connell, 2013; Pelger, 2016; Young, 2014; Zeff, 2002). Nonetheless, it has not fully paid account
attention to institutional complexity where multiple sources of “prescriptions” coexist (Greenwood et al., 2011) and its consequences. In relation to accounting standards, institutional complexity indicates competing pressures for change and continuity over “appropriate” accounting standards. The previous research has limited its analytical focus to the issue that can be merged under a single interpretation of appropriate practice concerning certain accounting standards. Examples include the acceptable practice under the names of sustainability accounting as well as stock options in financial reporting (Archel et al., 2011; Murphy and O’Connell, 2013; Pelger, 2016; Young, 2014). According to such studies, the due process plays an important part in giving credibility to particular actors’ interest(s), leading to the dominance of a particular interpretation of standards (Archel et al., 2011; Murphy and O’Connell, 2013; Pelger, 2016). Importantly, the standard setter presents the due process as “apolitical” and a technical procedure rather than a political one (Young, 2014). This paper extends this notion by embracing sources of competing pressures towards the standard setter by recognising institutional complexity, which results in divergent outcomes.

A set of accounting standards can be conceptualised as a prescription concerning the method of reporting financial statements. Such a perception of accounting standards has been increasingly prominent in accounting studies (Archel et al., 2011; Baudot, 2014; Chua and Taylor, 2008; Fogarty, 1993; Georgiou and Jack, 2011; Giner and Arce, 2012; Guerreiro et al., 2012; Holm and Zaman, 2012; Pelger, 2016). On the other hand, the existing literature has not fully explored the implication of institutional complexity in examining the role of local accounting standard setters. This paper aims to examine the following two issues: unpicking both competing pressures and local efforts at reconciling. These can be formulated into the following two research questions:

RQ1. What is the institutional complexity that local accounting standard setters face?

RQ2. How do local accounting standard setters translate those pressures?

Institutional complexity, in this paper, will be conceptualised in terms of discourse, linguistic practice, giving meaning to ideas (Phillips and Hardy, 2002). By recognising institutional complexity, explicit attention is paid to competing sets of discourse, which either support or reject the prescription(s) concerning accounting practice that inform how accounting practice should be arranged. For that, it is crucial to leverage the insights from those studies focusing upon discursive processes of acquiring social credibility known as legitimacy. Such processes involve linguistic interactions concerning the social acceptance of accounting standards (Archel et al., 2011; Bamber and McMeeking, 2016; Ezzamel et al., 2007). In order to unpick the role of local standard setters, the paper sheds light upon translation. The concept of translation captures how organisations, including local accounting standard setters, interpret such pressures and accord meaning in the local context that specify the name and acceptable practice of prescriptions (Czarniawska and Sevón, 1996, 2005; Erlingsdóttir and Lindberg, 2005; Røvik, 2016; Sahlin and Wedlin, 2008).

This paper focuses on the Japanese accounting standard setter’s efforts to reconcile IFRS adoption pressure and maintain local Japanese Generally Accepted Accounting Principles (GAAP) by translating them in the local context. The angle of this paper intends to embrace not only pressure for change, but also that for maintenance. That is, the Japanese Accounting standard setter, of the Accounting Standards Board of Japan (ASBJ) composed of 12 members of corporate executives, CPAs and academics, facing pressure from related parties. Competing pressures include those for IFRS adoption as well as to maintain the existing accounting standards widely adopted in Japan. The ASBJ translated such pressures by elaborating the relationship between the name and acceptable practice to be included under the name of particular accounting standards. Consequently, several options were provided for listed firms in Japan (i.e. “pure” IFRS issued by the International
Accounting Standards Board (IASB), Japanese GAAP that has witnessed chains of modification over the past decade or so, modified IFRS and US GAAP. Such a wide range of options can be summarised as an “explosion” of local accounting standards.

This paper first explains the theoretical background together with a key research gap. It justifies the importance of examining local accounting standard setters in relation to institutional complexity. Then, in the method section, the paper illustrates the detailed sources of data (textual data derived from the ASBJ, representatives of firms, accounting professionals and regulatory agency) and how they were analysed by drawing on the concepts of institutional complexity and translation. The empirical part analyses the ASBJ’s translation efforts that aimed to balance competing pressures and resulted in an “explosion” of accounting standards. Finally, the conclusion summarises the paper and clarifies its contribution.

Theoretical background

“Adoption” of IFRS

As socio-economic interactions across the border become deeper and more frequent, there has been increasing need for standardisation in the domain of accounting (Brunsson et al., 2012). Consequently, IFRS has been widely adopted as a mandatory requirement of financial reporting for listed firms in Europe since 2005 and a similar move has been seen across the globe (Cascino and Gassen, 2015). However, the mandatory adoption, here, does not necessarily mean the adoption of the exact standards issued by the IASB. Rather, as the previous research indicates, many economies carve out specific elements of IFRS in the local context (Nobes, 2015; Nobes and Zeff, 2016; Tsunogaya et al., 2015; van Mourik and Katsuo, 2014; Walker, 2010). Furthermore, the largest three world economies (the USA, China and Japan) have not requested the mandatory adoption of IFRS (Nobes and Zeff, 2016). In summary, standardisation activities in accounting have not necessarily resulted in convergence, but, rather, in divergence. However, the existing research has not provided insights into how such variation can be understood in relation to the role of local accounting standard setters.

That said, previous research has not entirely ignored the role of local accounting standard setters (Archel et al., 2011; Hassan, 2008; Irvine, 2008; Mir and Rahaman, 2005; Murphy and O’Connell, 2013; Pelger, 2016; Young, 2014; Zeff, 2002). These studies draw upon the institutional perspective in organisational analysis, which has highlighted the role of social acceptability or credibility, known as legitimacy, in the diffusion of a prescription that guides practice (Smets et al., 2012). Legitimacy concerning a particular prescription is accorded by certain arrangements of legal, normative and/or cognitive elements. Legal arrangements would be represented by “visible” legislation or regulation, while normative and cognitive arrangements may be “invisible”, since these are often exemplified by social norms and values, respectively. By drawing from the institutional perspective, the accounting standard could be considered as a prescription or a set of principle ideas that inform how accounting practice should be arranged.

Previous research has provided useful insights into the role of legitimacy in relation to local standard setters. However, it predominantly examines the process that results in consensus between the name and appropriate practice of particular accounting standards (homogeneity) rather than exploring the process that produces variety (heterogeneity) (Archel et al., 2011; Murphy and O’Connell, 2013; Pelger, 2016; Young, 2014). For example, Archel et al. (2011) illustrated a particular version of “sustainable accounting” prevailing over time in Spain. Similarly, Young’s (2014) research on the USA highlighted how the competing interpretations of “stock option” in relation to financial reporting (i.e. acceptable or not) are finally converged under a specific one. Regarding this, previous studies have indicated that the due process, allegedly an important process for creating, changing and
abolishing accounting standards, actually plays a significant role in legitimating particular actors’ interest(s) (Archel et al., 2011; Murphy and O’Connell, 2013; Pelger, 2016). The standard setter treats the due process as “apolitical” and a technical process rather than a political one (Young, 2014).

Young (2014), by drawing upon Mary Douglas’s (1966) work dealing with the boundary between “clean” and “dirty”, examined the role of the FASB, the US local accounting standard setter, in relation to the domain of the political and the technical in accounting standard setting. Young’s analysis focused on the testimony concerning share-based compensation in the US Congress. Most importantly, her study indicates that the FASB intended to present them predominantly guided by “clean” and unbiased or technical motivations rather than “dirty” and biased ones.

Our work is related to Young (2014) in that we also focus upon the standard setter’s “dirty” motives in standard setting activities. However, our work takes this notion a step further by embracing multiple sources of pressure to the standard setter as well as how they respond to them.

**Institutional complexity as competing sets of discourse**

However, previous research has not fully paid attention to institutional complexity where multiple sources of “prescriptions” coexist (Greenwood et al., 2011). Local accounting standard setters are exposed to competing pressures for change and maintenance concerning accounting standards.

In order to embrace institutional complexity, it would be necessary to pay attention to multiple sources of pressure. The competing pressures, namely pressure for change and maintenance, are exerted towards local accounting standard setters. That is, while they exert pressure for change and maintenance to other organisations in the local context, they are exposed to a similar sort of pressure derived from both domestic and international organisations. As Fligstein and McAdam (2012) rightly pointed out the organisation resides in multi-layered pressure for change and maintenance. For local accounting standard setters, they have pressure exerted either in international or local contexts. At an international level, international relationships play a vital part, while at a local level, inter-organisational relationships in the domestic setting do.

In order to embrace competing pressures, this paper utilises the concept of discourse. Discourse is defined as structured sets of text that provide meanings to entities (Phillips and Hardy, 2002), including, importantly, prescriptions for accounting practice. In fact, in the accounting research that draws on the institutional perspective, it has been increasingly prominent that pressure for change as well as for maintenance can be conceptualised in terms of discourse (Archel et al., 2011; Bamber and McMeeking, 2016; Ezzamel et al., 2007; Laine, 2009; Suddaby and Greenwood, 2005). According to such study, pressure for maintenance is equivalent to particular discourse that highlights legitimacy of the existing prescription, while for change it is the necessity of transforming it.

Moreover, discourse analytic conceptualization of competing pressures has been applied at various levels, including at the organisational level (Laine, 2009) and inter-organisational level (Suddaby and Greenwood, 2005). In particular, the latter level of analysis justifies the attention of this paper, namely, to the relationships between local accounting standard setters and relevant organisations, which will be further explicated in the following sections.

**Translation**

Local accounting standard setters interpret discourse that either supports or rejects the accounting standard(s). Such interpretation may be called translation (Czarniawska and Sevón, 1996, 2005; Erlingsdóttir and Lindberg, 2005; Rovik, 2016; Sahlin and Wedlin, 2008). This view has, in particular, been developed by a group of scholars often known as the...
Scandinavian School of institutionalism with its primary focus on the process of institutional dynamics. Most importantly, such translation may result in homogenisation (isopraxism) as well as heterogenization (isonymism) (Erlingsdóttfr and Lindberg, 2005). Erlingsdóttfr and Lindberg (2005) exemplified such a process concerning medical practice. Their analysis pays attention to the name and appropriate practice of new prescriptions that emphasise efficiency, represented by “quality assurance”, “accreditation of laboratories” and “chain of care”. Their analysis reveals the importance of how the name and the practice are delivered to the organisation (i.e. at the same time or separately) as well as how the local organisation interprets the meaning of practice.

Translation of discourse concerning accounting standards such as IFRS by local accounting standard setters also involves meaning accordance that specifies the name and actual practice of standards. Compulsory adoption of “pure” IFRS as well as carving out specific elements of IFRS may be contrasting the difference of translation by local accounting standard setters. The former and the latter might be under the same name, IFRS, but the actual practice would be significantly different (i.e. the former should be more or less identical to standards issued by the IASB, while the latter could be largely different from the “original” ones).

Although the Scandinavian school would be useful in understanding the actual process and divergent consequences of pressure for change and continuity, they do not necessarily pay explicit attention to competing sets of discourse or institutional complexity. It should be noted that the primary focus of this paper lies in embracing multiple and competing sets of pressure for change and continuity (institutional complexity), and local accounting standard setters’ responses to them. The concept of translation would be particularly helpful to elaborate standard setters’ responses to institutional complexity. However, again, the concept would be insufficient to adequately address institutional complexity.

To recap, this paper adopts the institutional perspective in extending the existing understanding concerning the dynamics between accounting practice and socially accepted prescriptions. By drawing upon the concept of institutional complexity, this paper embraces competing pressures. Furthermore, the concept of translation helps to capture the role of local standard setters under competing pressures that may result in not only homogeneity but also heterogeneity.

**Method**

**Overview**

As seen above, the paper aims to provide insights into the role of local accounting standard setters in the context of institutional complexity. For this purpose, the paper focuses upon the ASBJ, which was exposed to both pressures for change and for maintenance. The data used for the analysis were textual data from the ASBJ and relevant organisations that were primary sources of competing pressures. Regarding translation by the ASBJ, textual data released by the ASBJ were examined. The ASBJ itself issued outline minutes of their meetings as well as reports that inform the trajectory of accounting standards in Japan. In terms of pressure for change and that for maintenance exercised towards the ASBJ, these were observable from textual data produced by relevant organisations (the regulatory agency, representative of accounting professionals and representative of firms).

The actual process of analysis was two-fold. At the first stage, relevant textual data were explored and efforts were made to make sense of institutional complexity and the ASBJ’s translation, which led to the “explosion” of accounting standards in Japan. Consequently, it was found that institutional complexity could be elaborated by further examining sets of discourse for change and maintenance that either supported or rejected the new and existing accounting standards. On the other hand, the ASBJ’s translation could be investigated by observing name and appropriate practice of particular accounting standards, including IFRS.
and Japanese GAAP. In terms of the role of the local accounting standard setter, the observed “explosion” of accounting standards in the country was also found in the existing empirical investigation reporting the status of the IFRS adoption in Japan (Tsunogaya et al., 2015). Therefore, efforts were made to make sense of the ASBJ’s involvement in this.

At the second stage, further relevant data were explored and examined and themes of institutional complexity as pressure for change and maintenance and the ASBJ’s translation were fleshe out. For the systematic analysis of textual data, the data were analysed between July 2001 and July 2015. This is because the ASBJ became an official standard setter in the Japanese accounting field at the beginning of the 2000s (July 2001). Furthermore, the analysis of data up to July 2015 would be appropriate since “Japan’s Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications” (hereafter called “JMIS”) were released in June 2015. Moreover, 15 years of data would be reasonably long enough to embrace the above issues. In what follows, key textual data in each theme are explained.

Institutional complexity as pressure for change and maintenance

The local standard setter, the ASBJ, was exposed to both pressures for change and maintenance. In particular, competing pressures were locally observed in the country, from the regulatory agency, accounting professionals, and firms. As seen in Table I, the textual data concerning competing pressures were classified into the following four categories: mutual authentication, modification, carve out and active acceptance. Mutual authentication and modification belong to pressure for maintenance, while carve out and active acceptance pressure for change.

In terms of the regulatory agency, the Financial Services Agency of Japan (FSAJ) played a key part; before July 2001, the accounting standard setting was undertaken by FSAJ. In particular, the Business Accounting Council (Kigyokaikei Shingikai) of FSAJ was in charge of regulating accounting standards. Between 2000 and 2015, the council held several meetings every year. Consequently, they produced the following reports, which are available via their website: “Toward the convergence of accounting standards” (2006), “Regarding the treatment of IFRS in Japan” (2009) and “Current policy concerning responses to IFRS” (2013).

For the representative of firms, this paper focuses upon Keidanren (Japan Business Federation). Keidanren represents over 1,000 member firms. These are basically large Japanese firms, including major manufacturers (Toyota, Nissan, Honda, Hitachi and Toshiba). Historically, Keidanren played an important part in the formation of the Japanese industrial policy (Fletcher, 2012). With respect to accounting standards, Keidanren expressed their views occasionally between 2000 and 2014, which were available from their website.

Regarding accounting professionals, the Japanese Institute of Certified Public Accountants (JICPA) represents the interests of CPAs in Japan. The JICPA’s bulletin is published every month in printed format. Importantly, the January issue of this bulletin

<table>
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<tr>
<th>Types</th>
<th>Explanation</th>
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<tbody>
<tr>
<td>Mutual authentication</td>
<td>Illustrating the necessity to achieve mutual authentication of the Japanese accounting standards with other countries</td>
</tr>
<tr>
<td>Modification</td>
<td>Emphasising the importance of modifying certain elements of the Japanese accounting standards</td>
</tr>
<tr>
<td>Carve out</td>
<td>Advocating the necessity of carving out and modifying some elements of IFRS</td>
</tr>
<tr>
<td>Active acceptance</td>
<td>Arguing for the acceptance of “pure” IFRS</td>
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contained a paper titled “The review of the previous year and the outline of annual plans for the coming year” written by the then president of the JICPA. It was assumed that these articles represented the views of JICPA and thus were examined between 2000 and 2014 in relation to IFRS.

**ASBJ’s translation**

Throughout the analytical period, importantly, the background of ASBJ’s 12 members included the following three different categories: executives of Keidanren member firms, CPAs and academics[1]. It is reasonable to argue that executives of Keidanren member firms represented Keidanren’s interests, while CPAs the JICPA’s. Furthermore, accounting scholars played the central part in the accounting standard setting process, appointed as the FSAJ’s committee members before the ASBJ became an independent standard setter in the early 2000s. Therefore, of these three categories of members, academics in accounting would be closest to the FSAJ in terms of the opinion they held regarding the change and continuity of accounting standards in Japan. Therefore, amid the above competing pressures, it was clear that ASBJ translated such pressure in three different ways. As summarised in Table II, these were “modification”, “optional adoption” and “new standards”:

- **Modification**
  "Modification” indicates that the name of the Japanese GAAP should remain, while the existing practice specified under the name needs to be modified.

- **Optional adoption**
  “Optional adoption” is about the relationship between IFRS (name) and the scope of application of it (practice) in the Japanese context.

- **New standards**
  “New standards” involves new name and practice.

In a nutshell, ASBJ’s translation resulted in the “explosion” of accounting standards since they initially put emphasis on modifying the Japanese GAAP, and then started to add options for optional adoption of IFRS as well as the modified version of IFRS known as JMIS. For this examination, we relied on documents obtained from ASBJ’s websites that list outlines of minutes of meetings held at least once per month (316 meetings were held during the analytical period between July 2001 and July 2015)[2], together with key documents, including press releases, concerning JMIS. We carefully read through these and learnt that ASBJ’s meeting spent most of the time discussing the modification of the Japanese GAAP interpreted as maintaining the Japanese GAAP, and spent some time on developing JMIS[3], which contributed to increasing the variety of accounting standards in the country.

Based on these thematic classifications and data mentioned above, we further fleshed out the empirical part. The analysis will be shown in detail in the next section.

<table>
<thead>
<tr>
<th>Types</th>
<th>Explanation</th>
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<tbody>
<tr>
<td>Modification</td>
<td>Modifying the Japanese accounting standards</td>
</tr>
<tr>
<td>Optional adoption</td>
<td>Allowing for optional adoption of IFRS for Japanese firms</td>
</tr>
<tr>
<td>New standards</td>
<td>Developing JMIS as new standards that carve out and modify unacceptable elements of IFRS</td>
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**Table II.**
Types of translation
Analysis: “explosion” of accounting standards

Competing pressures

The IASB’s pressure for adopting IFRS has been constantly observed. That is, the scrutinised documents referred to the importance of IFRS in terms of socio-economic issues such as an increasingly internationalised world economy. In addition to this, pressure derived from the USA cannot be ignored (i.e. the FSAJ and Keidanren, in particular, was significantly influenced by the USA, which was explicitly mentioned in the relevant textual data we analysed). Against the backdrop of these international relationships, domestic pressure for change and maintenance was analysed by examining sets of discourse, which will be illustrated next.

FSAJ

The FSAJ discourse embraced modification, carve out and active acceptance, which is summarised in Table III. Initially, the FSAJ’s discourse concerning accounting standards emphasised “modification” or the necessity to modify the Japanese GAAP. However, the discourse was significantly changed and shifted towards “active acceptance”, after the FASB in the USA indicated the possibility to formally adopt IFRS in the country in 2008, which, according to them, would be later clarified with specific details such as the exact date to launch the adoption. The FSAJ in 2009 clearly mentioned the possibility to compulsorily require Japanese firms to adopt IFRS in the future. Again, the FASB refrained from further pursuing compulsory IFRS adoption for a while, which became clear around 2010. Consequently, the FSAJ’s discourse also refrained from actively promoting the compulsory adoption of IFRS and was more inclined to “carve out” and “modify”. These, respectively, indicated the necessity to modify the Japanese GAAP as well as hedge risks by holding various options of accounting standards, including one that carves out and modifies some parts of “pure” IFRS.

<table>
<thead>
<tr>
<th>Modification</th>
<th>Carve out</th>
<th>Active acceptance</th>
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<tr>
<td>“It would be necessary to prevent the Japanese accounting standard from being incommensurable from other accounting standards adopted in the rest of the world. Therefore, Japan needs to actively accelerate the ‘convergence’ of the accounting standard by modifying certain elements of the Japanese GAAP” (2006, “Toward the convergence of accounting standards”)</td>
<td>“There are certain elements in IFRS that do not properly reflect the business activities of Japanese firms, which would incur an unreasonable cost for firms to adopt […] this matter should take into account uncertainty regarding the trajectory of IFRS adoption across the globe, which is exemplified by the US attitude […] so, at this stage, it would be useful to seek possibilities of endorsement, where certain elements are modified and/or removed […]” (There are already some Japanese firms that adopt ‘pure’ IFRS, so it would be reasonable to secure options for adopting ‘pure’ IFRS […] which would be useful for those firms that already adopted and increase another option for other firms by customising IFRS, which would be also useful in showing the ideal IFRS from the Japanese perspectives” (2013, “Current policy concerning responses to IFRS”)</td>
<td>“It would be desirable to specify exact processes to be followed in case the compulsory adoption of IFRS is decided for certain Japanese firms […] which would be applied to consolidated financial statements, not individual financial statements” (2009, “Regarding the treatment of IFRS in Japan”)</td>
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Table III. Financial Services Agency of Japan’s discourse concerning IFRS
Keidanren’s discourse, in the early 2000s, was actively emphasising “mutual authentication” with other accounting standards such as IFRS and US GAAP (Table IV). That is, Keidanren took a position that intended to justify the significance of the Japanese GAAP. In particular, Keidanren pointed to Japanese ways of economic activities, which, according to them, prioritise long-term perspectives. That is, Keidanren argued that “pure” IFRS tends to emphasise the “asset-liability” approach that is primarily based on balance sheets, which allegedly accelerates short-term perspectives. In contrast, the Japanese GAAP adopts an “income-expense” approach, which, they argued, would be suitable for shareholders with intentions to own stocks on a long-term basis. However, similar to the FSAJ, Keidanren’s discourse drastically changed to “active acceptance” as the FASB indicated an IFRS adoption possibility. Keidanren’s discourse started to be inclined towards “carve out” and “modification”, which intended to maintain a couple of crucial elements in the Japanese GAAP as the FASB indicated their disinterest in immediately adopting IFRS for the American firms. Specifically, Keidanren’s discourse emphasised the necessity to maintain the existing treatment of current net income in the Japanese GAAP. According to Keidanren, the existing treatment of the current net income was significantly different between IFRS and the Japanese GAAP. Keidanren justified the existing treatment of “current net income” in terms of local business custom, which, 

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<th>Modification</th>
<th>Carve out</th>
<th>Active acceptance</th>
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<tr>
<td>“It would be necessary to actively communicate Japan’s viewpoint concerning the accounting standard, not simply following the global trend […] the reality of management practices varies and forcing a single accounting standard on them may be likely to result in nonsense, where the financial statements do not reflect what firms are doing” (2001, Official Announcement)</td>
<td>“[IFRS] emphasises asset-liability […] [the Japanese accounting standard prioritises income-expense that] let firms hold long-term perspectives, which, consequently, result in greater benefits for shareholders” (2006, Official Announcement)</td>
<td>“In case IFRS is adopted in Japan, it would be crucial to put primary emphasis on how to reflect the reality of Japanese firms’ management practices on financial statements” (2009, Official Announcement)</td>
<td>“The US maintained the American accounting standard, similar to Japan in the sense both countries hold their own standards […] but the USA newly included an option to adopt IFRS for US firms […] Japan should immediately specify a process to allow Japanese firms to optionally adopt IFRS” (2008 (March), Official Announcement)</td>
</tr>
<tr>
<td>“The crucial thing is that Japan, the USA and Europe have to achieve mutual authentication […] for example, IASB is against the reclassification adjustment, while Japan should propose to maintain the existing realisation concept [that allows the recategorisation adjustment]” (2003, Official Announcement)</td>
<td>“While FASB and IASB participate in mutual authentication concerning accounting standards […] Japan also needs to take an active part in this process and make efforts in promoting the significance of Japanese GAAP, while modifying the Japanese GAAP” (2007, Official Announcement)</td>
<td>“In terms of management of firms [in Japan], the vital thing is to appropriately make sense of current net income, income and expense, which are obviously not separable from the issue of reclassification adjustment […] importantly, these are lacking in IFRS, which partly explains why Japanese firms have not adopted IFRS since it was formally introduced as a possible option in the country” (2011, Official Announcement)</td>
<td>“In case IFRS is to be adopted on a compulsory basis, it would be necessary to hold three years, at least, for the preparation […] it would be vital to keep an eye on the US” (2008 (October), Official Announcement)</td>
</tr>
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</table>

Table IV. Keidanren’s discourse concerning IFRS
according to them, was appropriately reflected in the Japanese GAAP, but not in IFRS. Regarding this, there existed, at least, two crucial elements, including the treatment of “reclassification adjustment” and “goodwill” although the former was explicitly referred to by Keidanren, while the latter was mentioned implicitly. Keidanren pointed to the importance of maintaining the existing way of “reclassification adjustment” of comprehensive income, which was not allowed in IFRS. Historically, Japanese management practices tended to be associated with preference for long-term investment such as adherence to stable growth rather than maximising profits (Endo et al., 2015). For this purpose, it could be considered that “reclassification adjustment” provided opportunities for firms to equalise profit (Shuto, 2007). Furthermore, while the Japanese GAAP maintained the amortisation of goodwill at a fixed rate, IFRS did not (but required to do impairment under certain conditions). Again, for the long-term investment, amortisation of “goodwill” at a fixed rate was helpful. In brief, these contrasts result in different “current net income” between the Japanese GAAP and IFRS.

**JICPA**

The JICPA’s discourse can be classified by “active acceptance”, which illustrated the necessity to change the status quo over the period (“JICPA’s discourse concerning IFRS”). This can be understood in terms of their business opportunities. That is, changes in the status quo concerning the accounting practice brought business opportunities for CPAs. In the early 2000s, following US legislation of the SOx act, Japan amended the Financial Instruments and Exchange Act, which let Japanese CPAs witness an economic boom. The amendment required Japanese firms to adopt a new internal control system. Importantly, CPAs played a vital part in adopting the new system. The adoption of the new system was more or less completed in the mid-2000s, which provided an important context for understanding the JICPA’s statements (Shibata, 2011). The JICPA needed to seek new business opportunities since the booming demand was gone. Therefore, it would be reasonable to interpret that JICPA’s statements concerning active acceptance of IFRS reflected their economic interests.

JICPA’s discourse concerning IFRS is shown as below.

**Active acceptance:**

The accounting standard provides a universal rule that measures activities of firms, which should be the same across the globe and thus be trustworthy (2001, JICPA Journal).

JICPA supports Japanese firms to adopt IFRS for Japanese firms [...] IFRS would be increasingly important in the future, so JICPA would also make every possible efforts to strategically educate CPAs with good understanding of IFRS (2008, JICPA Journal).

The introduction of IFRS would be an unprecedented large-scale reformation of accounting practices, which further provides conditions where CPAs play bigger and more important roles. JICPA actively supports Japanese firms adopting IFRS (2009, JICPA Journal).

JICPA actively introduces relevant information concerning IFRS adoption that includes both domestic and foreign examples, together with proposing various projects to examine the nature of IFRS (2010, JICPA Journal).

Member organisations of JICPA have established the supporting system to provide relevant firms with insights into the adoption of IFRS [...] it may appear that the IFRS is not that rapidly adopted by Japanese firms [...] but it should be noted that the process is surely on its way (2011, JICPA Journal).

JICPA has made every possible effort to support IFRS adoption for Japanese firms [...] It is obvious that Japanese and Japanese firms cannot survive in international society without adopting IFRS (2012, JICPA Journal).
JICPA is clear about accelerating the adoption of IFRS by Japanese firms […] for this purpose, JICPA would be willing to disseminate information concerning the adoption of IFRS and seek ways to generate further environments that encourage the adoption (2013, JICPA Journal).

ASBJ’s translation and “explosion” of accounting standards

The competing pressures are summarised in Table V. Throughout the 2000s, the competing pressures were derived from discourse supporting the Japanese GAAP as well as the adoption of “pure” IFRS. In more detail, the adoption of “pure” IFRS pressure was enhanced in the late 2000s, since Keidanren’s and FSAJ’s discourse also supported the adoption due to the American pressure. However, Keidanren’s and FSAJ’s discourse, since the USA blurred the adoption policy, started to keep their distance from adopting “pure” IFRS. Consequently, in the early 2010s, the adoption of “pure” IFRS pressure was associated with JICPA, while Keidanren and FSAJ exerted pressure on modifying the Japanese GAAP as well as selective elements of “pure” IFRS.

Importantly, the competing pressures were balanced by ASBJ’s translation, which ultimately led to the explosion of accounting standards as seen in Table VI. In the early 2000s, the ASBJ was exposed to two opposing pressures that supported the adoption of “pure” IFRS (the JICPA) and modification of Japanese GAAP (Keidanren and the FSAJ). Consequently, they started to launch modification of the Japanese GAAP from those elements that would face little resistance in the country. This modification could be understood as translation efforts to maintain the name of Japanese GAAP while changing certain practice under the name such as the inclusion of comprehensive income.

In the late 2000s, the ASBJ was subject to pressure derived from discourse supporting the adoption of “pure” IFRS as well as the modification of Japanese GAAP. Importantly, at this time, in addition to the JICPA, FSAJ’s and Keidanren’s discourse partly supported the

<table>
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<tr>
<th>Period</th>
<th>Status of pressure (parties that advocated)</th>
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<tr>
<td>The early 2000s</td>
<td>Modify Japanese GAAP (Keidanren, FSAJ)</td>
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<td>Adopt “pure” IFRS (JICPA)</td>
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<tr>
<td>The late 2000s</td>
<td>Modify Japanese GAAP (Keidanren, FSAJ)</td>
</tr>
<tr>
<td></td>
<td>Adopt “pure” IFRS (JICPA, FSAJ, Keidanren)</td>
</tr>
<tr>
<td>The early 2010s</td>
<td>Modify “pure” IFRS (Keidanren, (FSAJ))</td>
</tr>
<tr>
<td></td>
<td>Modify Japanese GAAP (Keidanren, FSAJ)</td>
</tr>
<tr>
<td></td>
<td>Adopt “pure” IFRS (JICPA)</td>
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Table V. Trajectory of competing pressure

Modification

“As a result of discussion, it would be necessary to begin [modification of the Japanese accounting standards] from those considered to be relatively easy [due to little resistance from stakeholders] [...] such as valuation basis of inventory, segment information, disclosure of related party, unification of accounting standards of foreign subsidiaries, investment property” (2006, March, Official Announcement)

Optional adoption

“It would be certainly true that IFRS adoption would be beneficial for certain related parties, including some investors, some of those people producing consolidated financial statements and some auditors [...] in this sense, ASBJ agrees with the optional adoption of [“pure”] IFRS as soon as possible” (2009, April, Official Announcement)

New standards

“It would be necessary to maintain optional adoption of [“pure”] IFRS since certain firms already adopted [...] but it would be equally important to ‘carve out and modify’ certain elements of IFRS, which would be helpful in adopting IFRS and showing Japanese attitude toward IFRS [...] there exist certain elements that should be carved out and modified, which include amortization of goodwill [...] adjustment reclassification and current net income” (2015, June, Official Announcement)

Table VI. Translation: “explosion” of standards and ASBJ
adoption of “pure” IFRS. In turn, the ASBJ translated the pressure by further progressing with the modification of Japanese GAAP and allowing for optional adoption of “pure” IFRS[4]. To recap, in terms of translation, the latter (i.e. allowing for the optional adoption of “pure” IFRS) could be understood as retaining the name of IFRS, while changing the existing practice from an excluded option to a possible alternative. However, pressure on adopting “pure” IFRS was, more or less, weakened around the early 2010s and related parties, particularly FSAJ’s and Keidanren’s discourse, emphasised modification of IFRS as well as Japanese GAAP. In effect, ASBJ translated such pressure by examining elements of IFRS to be carved out and modified. In a nutshell, ASBJ’s translation adopted the name of JMIS, released in June 2015, which, as practice, held certain elements that were significantly different from “pure” IFRS. Such elements included the perception of current net income, which was strongly associated with treatments that allowed for adjustment reclassification and amortisation of goodwill at a fixed rate. In summary, as a result of translation, at least three options were enabled for Japanese firms concerning accounting standards, including the Japanese GAAP, “pure” IFRS, and JMIS. Furthermore, although it was not addressed in this paper, the ASBJ allowed the usage of the US GAAP for Japanese listed firms[5]. Consequently, Japanese firms had four possible options for their financial reporting standards.

Conclusion
To recap, the key research gap that this paper aimed to address was that the existing research had not provided insights into the role of standard setters under institutional complexity that result in divergent outcomes. That is, the existing research assumes a single interpretation, out of competing and often conflicting ones, concerning accounting standards prevailing (Archel et al., 2011; Murphy and O’Connell, 2013; Pelger, 2016; Young, 2014). In order to address this shortcoming, the paper has identified two distinctive issues of unpicking competing pressures (RQ1) and local standard setters’ efforts to reconcile such pressure by translation (i.e. elaborating the relationship between name and practice of accounting standards) (RQ2). Competing pressures are addressed by leveraging the insights from those studies focusing upon discursive processes (Archel et al., 2011; Bamber and McMeeking, 2016; Ezzamel et al., 2007). On the other hand, the role of local accounting standards is addressed by drawing upon the concept of translation (Czarniawska and Sevón, 1996, 2005; Erlingsdóttir and Lindberg, 2005; Røvik, 2016; Sahlin and Wedlin, 2008).

Empirically, the Japanese local standard setter, the ASBJ, was exposed to competing pressures since their members included CPAs, executives of firms and academics. Importantly, ASBJ balanced these by translating such pressure and elaborating the relationship between the name and appropriate practice of particular accounting standards. Consequently, ASBJ increased the options of accounting standards for Japanese listed firms, which could be summarised as an “explosion” of local accounting standards.

To our knowledge, this paper is the first paper systematically examining the role of local standard setters under institutional complexity that witnessed divergent outcomes. The existing research sheds light on the role of local accounting standard setters but does not fully explore the implication of competing pressures (Archel et al., 2011; Hassan, 2008; Irvine, 2008; Mir and Rahaman, 2005; Murphy and O’Connell, 2013; Pelger, 2016; Young, 2014). The paper has illustrated the limitation of such a conceptualization and placed the local accounting standard setters under competing pressures. The findings of this paper suggest that competing pressures are not necessarily merged under a convergent outcome, where consensus is made regarding the appropriate practice of the particular accounting standards (name). Rather, multiple sources of pressure coexist long-term and result in divergence regarding name and practice as seen in this paper. Therefore, the role of the local
standard setter should be contextualised in the competing pressures derived from local as well as international contexts.

This paper also has certain limitations. Most importantly, although this paper made the most of the available data, the translation process by the ASBJ may be more nuanced. Furthermore, in contextualising the role of local accounting standard setters in institutional complexity, this paper has put primary emphasis on domestic pressure. However, there exist clear missing links with international pressures. This interplay between domestic and international pressures needs to be further elaborated in future studies. Additionally, this paper did not fully shed light upon the interaction at a country level. That is, member countries contribute to the IASB in several ways, including financially. Therefore, the amount of financial contribution, for example, would potentially influence the degree of freedom concerning translation of member countries. These issues may need to be further considered.

Notes

1. In 2014, for example, then the ASBJ’s members were four CPAs, seven executives of Keidanren firms and one academic.
2. www.asb.or.jp/asb/asb_j/minutes
3. The purpose built committee under the ASBJ started to develop JMIS in August 2013. In total, 22 meetings were held before the release of JMIS in June 2015.
4. More specifically, it was officially approved in March 2010.
5. It was confirmed that international pressures were exerted from the USA to the ASBJ and, hence, several Japanese firms actually adopted the US GAAP (Eng et al., 2013; Tsunogaya et al., 2015). However, this paper, as an initial step to provide insights into the role of local standard setters, put primary emphasis on examining discourse concerning domestic pressures, which were exerted by the regulatory agency, representatives of firms and accounting professionals.

References


**Further reading**


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Role of local accounting standard setters
Trust and control in evolving inter-organisational relationships
Evidence from the aerospace industry

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Abstract

Purpose – The purpose of this paper is to contribute to debates about the relationship between trust and control in the governance of inter-organisational relationships. In particular, the authors focus on the question of how the relationship between trust and control shifts over time.

Design/methodology/approach – An in-depth case study was conducted in a company operating in the aerospace industry. The authors aim to understand this company’s practices and, at the same time, to use the case study to deepen the knowledge of the complex trust/control nexus. The authors follow the changes in the relationship between trust and control as the company restructured its supply chain, and discuss issues which it had to address in the later phases of the supply chain restructuring.

Findings – The paper illustrates the duality of the trust/control nexus. The authors show how the studied company coped with the complex relationships with its suppliers as collaboration increased. The authors identify particular control mechanisms that the company developed to manage such complexity, such as a supplier strategy and a relationship profile tool.

Research limitations/implications – The paper studies supply chain restructuring and the changing relationship of trust and control over time only from the perspective of the assembler/manufacturer which “owns”/manages the supply chain.

Originality/value – The authors observe a move from inter-personal trust to inter-organisational trust. Furthermore, the authors illustrate how managers can intervene to maintain and stabilise trust and ensure that trust and control do not degrade or escalate beyond desirable levels.

Keywords Control, Inter-organizational relationships, Trust, Duality, Aerospace industry, Supply chain maturity model

Paper type Research paper

1. Introduction

Various scholars have explored the way in which trust is constituted in inter-organisational relationships. Although referring specifically to the context of management control within organisations, Merchant (1985) noted that “almost every control system involves some degree of trust that the individuals of concern will do what is best for the organisation without any, or with only incomplete, monitoring of actions or results” (p. 39). It is only relatively recently that researchers have started to examine the relationship between trust and control in inter-organisational relationships and to date no consensus has been reached (see e.g. Caglio and Ditillo, 2008; Chua and Mahama, 2007; Dekker, 2004). However, trust is important in inter-organisational relationships, as trust assists in resolving the paradox of inter-organisational relationships where partners can also be competitors. The existence of trust enables such partners to exchange sensitive information and promotes interaction and commitment.

Although some studies have explored the relationship between trust and control in inter-organisational relationships, how this relationship shifts over time has not been

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extensively studied (see Tomkins, 2001, for a notable exception). While Tomkins (2001) highlighted that the relationship between trust and control could change as the relationships between the partners change, much of the literature explores the relationship between trust and control from a rather static perspective (Coletti et al., 2005; Das and Teng, 2002) and as a consequence it fails to offer insights into the processes through which trust develops as inter-organisational relationships mature. In general terms, it is necessary to achieve a balance between trust and control (Das and Teng, 2001), but this is unlikely to be a simple and static balance as inter-organisational relationships themselves change over time (Tomkins, 2001). Even though the relationship between trust and control may change as the relationship changes, the existing literature adopts a rather static approach in studying the relationship between trust and control. However, there are calls in the literature for research to adopt a more dynamic approach and to study trust and control across the life cycle of an inter-organisational relationship (see e.g. Das and Teng, 2002; Langfield-Smith, 2008). Furthermore, other academics have called for further research into the trust building process (Caglio and Ditillo, 2008; Free, 2008; Meira et al., 2010).

In this paper, we examine the relationship between trust and control in inter-organisational relationships and, in particular, how trust develops as inter-organisational relationships mature. We study the inter-organisational relationships of a company in the aerospace industry as it restructured its supply chain. Although studies of supply chains are increasingly popular in a number of disciplines, they have received only relatively moderate attention from accounting scholars. We adopt a longitudinal perspective and study the trust/control nexus as the studied supply chain moved from arm’s length relationships to (eventually) partnerships. To provide a structure for our analysis of how the relationship between trust and control shifts over time, we draw on the supply chain maturity model (SCMM) of Berry et al. (2000). More specifically, we study how the aerospace company moved from arm’s length relationships with its suppliers (autonomous firm phase) to identifying preferred suppliers (serial dependence phase), then to increased collaboration (reciprocal dependence phase) and finally to establishing partnerships with preferred suppliers (mutual dependence phase)[1]. We argue that in the early phases the trust/control nexus can be conceptualised as a dualism. However, as we will show, over time as the supply chain matures and relationships become more collaborative and complex we need to understand the trust/control nexus as a duality. We thereby contribute to the discussions of the relationship between trust and control in the governance of inter-organisational relationships; specifically we demonstrate that the relationship shifts over time. Although our data do not enable us to explain in detail how or why it changed over time, we are able to examine and compare the relationship between trust and control in each of the four phases of the SCMM.

The paper has two dimensions; first, we examine the process of moving to a “mature” supply chain and second we explore issues which arise when the supply chain has matured. Due to the importance and complexity of the later phases of the SCMM, and the duality of trust and control in those phases, we will focus more on those later phases, namely, the reciprocal dependence phase and mutual dependence phase. We will describe mechanisms developed in practice to manage collaboration in these later phases, and, in particular, mechanisms designed to maintain trust in an extended supply chain where there is significant staff turnover. In such a context, we observed an attempt to standardise and depersonalise trust in order to provide a more formalised approach for managing collaboration. The remainder of the paper is structured as follows. In the following section, we discuss the notion of trust and the literature on the trust/control nexus. Then, we discuss our research design and subsequently present our case study. We conclude by discussing our findings and their implications.
2. Trust and control: theoretical underpinnings

Trust is frequently referred to as the “willingness of one party to relate with another in the belief that the other’s actions will be beneficial rather than detrimental to the first party” (Child and Faulkner, 1998, p. 45); where this willingness “is held without undue doubt or suspicion and in the absence of detailed information about the actions of that other party” (Tomkins, 2001, p. 165) or “irrespective of the ability to monitor or control that other party” (Mayer et al., 1995, p. 712). As such, trust provides the basis for an expectation which reduces the fear that the other party will act opportunistically (Bradach and Eccles, 1989; Gulati, 1995). This expectation can be based on contractual, competence and/or goodwill trust. Contractual trust reflects accepted standards of honesty and is the expectation that the other party will fully honour the agreement (oral or written). Contractual trust is embedded in the transaction and usually exists prior to contracting (van der Meer-Kooistra and Vosselman, 2000). Competence trust reflects the confidence that the other party has the necessary capabilities to perform the task satisfactorily (Sako, 1992). Competence trust is often related to objective expectations, such as the partner’s management or technical capabilities, skills, know-how and reliability (Das and Teng, 1998; Dekker, 2004). Goodwill trust “is a sure feeling that trading partners possess a moral commitment to maintaining a trading relationship” (Sako, 1992, p. 10). Shared norms and values, the absence of opportunist behaviour in the past, and an open commitment and reciprocity are preconditions for the establishment of goodwill trust (Sako, 1992).

The literature provides a plethora of classifications and different concepts of trust, though many concepts seem to share similarities. For example, Nooteboom (2002) distinguished thin and thick trust, where thin trust arises from macro sources, such as the institutional environment of the partners (i.e. norms, values, laws), while thick trust originates from micro sources, such as reputation, friendship, routines, etc., and is therefore more personalised. Thin trust only compensates for the possibility of negative behaviour, without creating any positive expectations, and thus is a necessary but not a sufficient condition for the continuance of an inter-organisational relationship. As such, thin trust needs to be reinforced by the development of thick trust. Building on thin trust, partners when entering into a new relationship “must have the willingness” to undertake behavioural risks, and form positive expectations about the other partners’ behaviour (van der Meer-Kooistra and Vosselman, 2010, p. 91). Such positive expectations, through processes of trust building, may result in thick trust.

Various claims have been made in the literature about the relationship between trust and control and studies have identified complex interconnections between them. Some scholars conceptualise the trust/control nexus as a dualism, where “trust and control are two separate routes to risk reduction” (Das and Teng, 2001, p. 276). Studies that treat the trust/control nexus as “distinct linkages” have shown that trust can be an alternative to or substitute for control. Knights et al. (2001, p. 314) pointed out that “a long tradition of management thought conceptualises trust and control as opposing alternatives”, where formal control allows the development of limited trust and vice versa. For example, the existence of trust can mitigate the need for control, especially in cases where activities and output cannot be measured with any certainty (see Dekker, 2004; Tomkins, 2001; van der Meer-Kooistra and Vosselman, 2000; Vosselman and van der Meer-Kooistra, 2006). So if trust is damaged or reduced, there will be more emphasis on formal control, while if trust increases, there is less need for formal control (Inkpen and Currall, 2004; Vlaar et al., 2007). On the other hand, the establishment of more control mechanisms will reduce the need for trust. Furthermore, Free (2008) showed that the extensive implementation of control can actually damage established trust.

Other studies, however, see the relationship between trust and control as a complementary one, where trust and control reinforce each other. Cooper and Slagmulder (2004) conceptualised
trust as a necessary condition for the adoption of specific control techniques, such as open-book accounting. The development of both contractual and goodwill trust can mitigate the risk of opportunistic behaviour between the partners and the possible abuse of the unequal bargaining power created by information asymmetry (Sako, 1992; van der Meer-Kooistra and Vosselman, 2000). Inkpen and Currall (2004) argued that in a supply chain relationship the selection of initial control mechanisms will depend on the level of trust between the partners. Furthermore, a close relationship will not develop unless there is trust (Das and Teng, 1998; Tomkins, 2001). In addition, Tomkins (2001) claimed that in the early and middle stages of the development of a relationship, control mechanisms help trust to develop, as a certain level of trust is needed to achieve effective control over one’s partners, though in later more mature stages, further control can harm trust. Control mechanisms generate information which can promote the development of competence trust (Das and Teng, 2001). Higher levels of control enable managers to interpret their partners’ behaviour (Vlaar et al., 2007) as control mechanisms help managers to develop shared expectations and to coordinate their activities (Mayer and Argyres, 2004). Furthermore, through regular contacts, the development of mutual interests (Das and Teng, 2001; Langfield-Smith and Smith, 2003) and the two-way flow of information derived from the application of control mechanisms (Sako and Helper, 1998), goodwill trust can be enhanced. The closer the partners work together, the greater the development of goodwill trust (Langfield-Smith, 2008).

In contrast to the literature that sees trust and control as a dualism, Möllering (2005) argued that trust and control should be conceptualised as duality, as they “each assume the existence of the other, refer to each other and create each other, but remain irreducible to each other” (p. 284). Even though Möllering saw control mechanisms only as monitoring mechanisms, he claimed that trust assumes the existence of control and control assumes the existence of trust, in such a way that one is not sufficient if it is not supported by the other. Khodyakov (2007) studied the processes in creative organisations and provided empirical evidence that trust and control are mutually irreducible concepts that are always co-present. He argued that during his study “it was hard to understand when collaboration is facilitated by trust or control, which suggests that these governance strategies cannot be fully understood without considering the roles both of them play at the same time” (Khodyakov, 2007, p. 15). Möllering’s (2005) and Khodyakov’s (2007) comments about trust and control as dualities are not alien to the accounting literature. Vosselman and van der Meer-Kooistra, in their 2009 paper, pointed out that control and trust can be seen as highly interrelated complements, which are instrumental in absorbing uncertainty, and that one cannot exist without the other. They conceptualised the trust/control relationship as an interactive one, whereby it can be both complementary and supplementary at the same time in order to reach positive expectations about future behaviour (also, see Das and Teng, 1998). Control mechanisms can be seen as the carriers of trust, as they create a platform that will encourage and build further trust. Embedded control structures, which provide a basis for the development of thick trust, mitigate the fear that the other party might engage in opportunistic behaviour (van der Meer-Kooistra and Vosselman, 2010). Vosselman and van der Meer-Kooistra (2009) claimed that “a trust-based pattern is not necessarily a substitute for formal control, but that trust (building) may interact with formal control as it is incorporated in a governance structure” (p. 6).

Veze et al. (2008) studied the influence in management control systems on firmly established trust in the mature stages of open-ended inter-organisational relationships. Drawing on a longitudinal case study of the distribution channels of a manufacturing company, they argued that greater trust can be built through the use of management control systems, even where trust is already high. Similarly, Langfield-Smith and Smith (2003, p. 304) pointed out that “trust may be compatible with the development of tighter accounting controls and contracts if trust is already well established and those
controls develop in a supportive and cooperative manner involving both parties”. As van der Meer-Kooistra and Scapens (2008, p. 381) explained, “trust can be built where the governance of these relationships provides sufficient structure to mitigate the risks which are involved in co-operation between independent parties who may have different motives and interests, while at the same time allowing individual capabilities and knowledge to be exploited for the mutual benefit of all the parties”.

As we see, contradictory claims/findings have been reported in the literature. On the one hand, control mechanisms can have negative effects on trust in later stages of a relationship where trust is well established (Free, 2008; Tomkins, 2001). Similarly, Dekker (2004) argued that trust can be damaged in cases where control mechanisms exceed what is necessary to safeguard the activities. On the other hand, other studies (Halinen et al., 1999; Vélez et al., 2008) have shown that control mechanisms cannot damage trust if there is an expectation of the continuity in the relationship. While introducing additional control mechanisms could damage trust when the “maximum” level of confidence has been reached in a one-off relationship, if the relationship is open-ended and expected to continue, additional control mechanisms could contribute to the stability of the relationship and facilitate its continuing evolution (Halinen et al., 1999; Vélez et al., 2008). Similarly, Sako (1992) argued that in cases where partners show a willingness to continue their collaboration, for example through investments in systems which allow partners to share knowledge and technology, additional control mechanisms can further enhance competence trust. So, control mechanisms may generate the information that is required to strengthen competence trust and thereby contribute to the continuity of the relationship. Nevertheless, Vlaar et al. (2007) pointed out that although the trust/control dynamics might alter, we know little about how managers can intervene to ensure that trust and control do not degrade or escalate beyond desirable levels.

From the above it seems that the findings of the literature are ambiguous and remain open to debate (Vélez et al., 2008). However, we do not see these different views of the relationship between trust and control as necessarily contradictory. Instead, we believe that the apparently ambiguous findings can be due to the different phases of maturity and collaboration in inter-organisational relationships, as “trust and control do not automatically become a duality. Instead each organisation goes through a process of institutionalizing trust-control duality” (Khodyakov, 2007, p. 17). This duality perspective enables us to analyse the shifting emphasis placed on trust and control over time. So, although trust and control may be complementary at certain times, the relative emphasis on control and trust may change over time. As Möllering (2005, p. 289) pointed out, the trust and control duality implies “not only a potential relationship between trust and control, but also an inevitable connection and reflexive influence”. This motivated us to explore the dynamics of the trust/control nexus by studying the different phases in the process of supply chain restructuring.

As mentioned earlier, to structure the analysis of our data we will draw on the SSCM of Berry et al. (2000), which identifies four distinct phases in the process of supply chain restructuring. In the first phase, the autonomous firm phase, the supply chain comprises essentially market-based arm’s length relationships (Cullen and Meira, 2010). In this phase, there is little or no “familiarity” between the organisations and the relationships are contract based, with contracts awarded to the suppliers with the lowest bids (Lamming, 1993). The second phase, the serial dependence phase, represents the beginning of a more collaborative relationship. Dominant or preferred suppliers are identified and encouraged to commit to the relationship by investing in the necessary productive capacity and management skills (Lamming, 1993). There is a focus on managing suppliers and supply chain management is given more strategic intent. The third phase, the reciprocal dependence phase, entails close collaboration with suppliers (Berry et al., 2000). The importance of close relationships with suppliers is increasingly recognised (Lamming, 1993), there is much sharing of information across organisational boundaries,
and advanced management systems are used to manage the supply chain (Lockamy and McCormack, 2004). In the final phase, the mutual dependence phase, collaboration with suppliers has been established and the focus of attention now shifts to the development of a partnership and to the governance of the collaborative relationship. Collaboration is routine and firmly established performance measures are in place to manage the supply chain (Lockamy and McCormack, 2004).

3. Research design
To study the relationship between trust and control in the various phases leading to supply chain maturity, we conducted an interpretive case study to provide the thick descriptions which are needed to generate in-depth understandings of this phenomenon (Berry and Otley, 2004; Ferreira and Merchant, 1992). The case study has twin roles: to understand the practices of the company by drawing on the above concepts; and, at the same time, to use the case study to deepen our knowledge of the trust/control nexus.

Interpretive research involves ongoing reflection on the data. In the interpretive paradigm, researchers do not seek to control empirical phenomena, rather they try to "enrich people’s understanding of the meanings of their actions" (Chua, 1986, p. 615). Thus, the role of theory is to explain action. In interpretive accounting research, theory plays an important role and is both the input and output of an interpretative case study (Ryan et al., 2002; see also Scapens, 2004). Interpretive research seeks to understand the studied phenomena in terms of existing theory, but through the research findings that theory may be "refined, modified or even rejected" (Ryan et al., 2002, p. 150).

This paper is part of a larger research project[2]. In this larger project, we started by exploring the governance of inter-organisational relationships as we particularly wanted to study accounting, performance measurement and control in an inter-organisational context. Initially, we gained access to the studied company and then began our data collection. The timing was fortuitous as we soon realised that the company was in the process of restructuring its supply chains. As we interviewed various people in the company and started to analyse our findings, it became clear that the relationship between trust and control was changing as the company moved through the various phases in its supply chain restructuring. As mentioned earlier, to provide a structure for our analysis of the phases of the supply chain restructuring we drew on the SCMM of Berry et al. (2000). Using the SCMM enabled us to study how the relationships between the parties and the trust/control nexus changed as the supply chain matured. Even though our study focussed on supply chain restructuring, we would expect similar changes in other types of inter-organisational relationships, as the relationships mature and the parties collaborate more closely.

The subject of the case study is a company operating in the aerospace industry, which we refer to as AIR (to maintain confidentiality). Our fieldwork took place at the company’s largest manufacturing/assembly site in the UK, and focussed on the supply chain for a specific component used in the manufacturing process. Having access to AIR proved to be particularly interesting because of the characteristics of the aerospace industry. The aerospace industry is a knowledge-based industry with high quality products; it is subject to intense competition and extreme levels of complexity; and, most importantly, it has high rates of outsourcing. A prominent feature of the aerospace industry is the high interdependency, close linkages and long-term relationships between manufacturers and suppliers. In recent years, a significant challenge for the industry has been to improve its supply chains (Smith and Tranfield, 2005). The traditional supply chain, with simple buyer-supplier relationships, not only leads to production delays, but also limits product development. Thus, the industry has been seeking to restructure its supply chains and to increase collaboration with suppliers. Our case study aims to show how the relationship between trust and control evolves within such a supply chain restructuring process.
Thus, our focus is on the organisation which is managing its supply chain. Specifically, we are looking at an organisation which is going through a process of change in the way it manages its suppliers, rather than looking at the network of suppliers as a whole, or individual supply chain relationships.

Our main data collection technique was semi-structured interviews. Between 2006 and 2009, during ten-site visits, we conducted 20 interviews with employees directly involved in the specific supply chain we studied. We interviewed 11 senior managers, middle-level managers and accountants spanning various departments – i.e. finance, purchasing and operations (see Table AI). These interviews enabled us to understand their experiences in the different phases of the supply chain restructuring. The interviews typically lasted for one to two hours and were directly or indirectly related to the management of the studied supply chain. The interviews were recorded and subsequently transcribed verbatim, with the exception of two interviews in which the interviewees did not want to be recorded and so detailed notes were made after those two interviews. We complemented the interviews with secondary data, such as relevant company documents (contracts, meeting agendas, scorecards, management reports and other formal documents). In addition, other data were collected from public sources, namely press releases, newspaper articles, investors’ presentations and annual reports.

Our study took place during and after the completion of the supply chain restructuring in AIR. For the purpose of this paper, we identified comments, events and issues which relate to the relationship between trust and control in the different phases in the SCMM. This enabled us to explore how trust and control change over time. The discussion during the interviews focussed primarily on the supply chain restructuring and the development of control mechanisms and accounting techniques. Specific questions were not asked about trust – instead we inferred levels of trust from the comments made and the procedures deployed, although at times some of the interviewees did specifically mention trust. However, to understand trust we have to look not only at what people say, but also at what they do, i.e. we have to look for “the subjective meanings that people attach to things” (Lukka, 2010, p. 112).

The restructuring of AIR’s supply chain began in 2004 following a critical consultant’s report (which will be described later). In this paper, we focus more particularly on the changes that took place in the later phases of restructuring which were contemporaneous with our research (2006-2009). For the earlier phases, we had to reconstruct how the supply chain had changed from people’s memories of those changes. The more detailed contemporaneous information enabled us to gain deeper insights into the later phases, and especially the final phase. As we will show below, the later phases are particularly interesting as AIR’s supply chain management team developed new and quite sophisticated control mechanisms which were intended to “formalise” trust in a context where there was significant staff turnover.

We recognise that in interpretive research the traditional criteria of reliability, validity and generalisability can be problematic and alternative criteria such as procedural reliability, authenticity/plausibility and transferability are more appropriate (see Parker and Northcott, 2016; and also Ryan et al., 2002). In terms of procedural reliability, in this section we have set out our research design and methods of data collection and analysis. For example, data collected in (early) interviews were discussed in subsequent interviews in order to seek clarification and corroboration. Furthermore, both internal and external documentary information was used to corroborate our interpretation of the interviews. Also, NVivo was used to organise and code the data. We hope that in writing this paper we have demonstrated both the plausibility and authenticity of our study[3]. Although our analysis was guided by the existing literature, it has to be acknowledged that the influence of the researchers cannot be excluded, and any interpretation of qualitative data is subject to data limitations and the
complexities and limitations of the human mind (see McKinnon, 1988, pp. 37-39). As such the interpretation of the case study is “our” interpretation, but it is grounded in the existing literature and based on multiple data sources. The challenge in presenting such an interpretation is to convince the reader that our interpretation makes sense and that it is based on appropriate evidence (Golden-Biddle and Locke, 2007). This we seek to do in the following section. Finally, we emphasise that rather than seeking to generalise our specific findings to all supply chains, or even to all supply chains in the aerospace industry, we would argue that the social processes surrounding the trust/control nexus, which we study in this paper, are likely to be applicable in other supply chains and that the theoretical insights we will gain through this study are thereby transferable to other settings; as such we are making a theoretical generalisation (see Parker and Northcott, 2016, p. 1111).

4. Restructuring the AIR’s supply chain

Background
AIR is a leading UK-based company, which employs considerably more than 20,000 people globally[4]. It has numerous subsidiaries operating in different business segments, one of which is the aerospace industry. AIR can be described as a system integrator and its competitive advantage is the high quality of its products. Following the general trend in the aerospace industry to streamline supply chains and to increase collaboration with suppliers, in 2004 AIR’s senior management team decided to restructure its supply chains in an attempt to improve its performance and to protect its competitive position. In this paper, we focus on the supply chain for an intermediate component in AIR’s principal products for the aerospace industry. AIR as the final assembler of the output is the “dominant partner” within the studied supply chain. However, we should point out that although it is dominant, its intention in restructuring its supply chains was, not to take control, but to govern the supply chain through collaboration. It is the need for high quality products and the social and economic consequences of faulty products that drive its decisions. As we will see, it is difficult to change suppliers (or partners) in a mature supply chain when there is close collaboration between them and this increases the bargaining power of the smaller parties.

Traditionally, AIR has dealt with suppliers on a project-by-project basis, where a project is for the supply, over a period of usually three to five years, of a particular part/component or type of material or service. As the relationships with suppliers moved towards partnerships, the definition of a project became rather vague because AIR’s relationships with its suppliers began to change. Nevertheless, it is important to recognise that a transaction with a supplier is not for the supply of something at a specific point in time, but an agreement to provide the continuing supply over a period of time, according to an agreed schedule. The supply chain for the intermediate component we studied comprises both internal and external suppliers. Before the restructuring, as well as a large number of arm’s length relationships (in the region of five hundred), there were three joint ventures (JVs). As a result of the supply chain restructuring, the number of arm’s length relationships was reduced substantially (to approximately forty) and those that remained evolved into much closer collaborations. The three JVs continued to be suppliers throughout the restructuring process, but they also underwent significant changes.

The process of supply chain restructuring in AIR can be divided into three chronological periods which can be mapped onto the different phases of the SCMM. These three periods are: prior to 2004 (autonomous firm); 2004-2006 (reciprocal dependence); and 2006 onwards (mutual dependence). However, 2004 represented a milestone in the supply chain restructuring and it can also be treated as a phase in the SCMM (serial dependence). The four phases are summarised in Table I. The following sub-sections are organised according to the above chronological periods, and in each period we will use the SCMM to structure our discussion of the trust/control nexus.
Early stages: up to 2004

The situation in AIR prior to 2004 can be categorised as the first phase of the SCMM – the autonomous firm phase (see Berry et al., 2000); where the supply chain comprises essentially market-based arm’s length relationships (Cullen and Meira, 2010) and inter-organisational relationships are generally unstructured and not very well defined. At that time AIR’s management was following the traditional style of purchasing and, as mentioned earlier, procurement was through one-off projects. As materials, parts, etc. were acquired through arm’s length relationships, and the individual projects were characterised by low asset specificity, it was quite easy to switch suppliers. In general, each project was allocated to the supplier with the lowest bid, a practice that is a common characteristic of the first phase of the SCMM (Lamming, 1993). During this phase, the only control mechanism in place was the contract, hence performance was difficult to manage and predict, but nevertheless there was a positive expectation that suppliers would not behave opportunistically and would honour their contracts. This positive expectation led to the development of contractual trust.

When a new project was being negotiated a contract review took place prior to signing the contract. This contract review systematically considered all the necessary activities and defined the quality, delivery and cost requirements. However, although there was a positive expectation that the suppliers would honour the contract terms, trust was not explicitly considered. Furthermore, there was no distinction between suppliers who were external and those who were internal (namely, the JVs). Purchasing managers simply allocated the project to the suppliers that met AIR’s quality requirements and had the lowest cost. According to one purchasing manager (3)[5]:

If they [internal suppliers] are not as competitive, we outsource the work externally. So from the purchasing, commercial and supply chain perspectives, they [internal suppliers] must feature equal or better performance than the external. It’s got to be the way to make decisions based on quality, cost, delivery and responsiveness. You cannot assign the work internally just because of an “intimate” relationship.
When the contract review was complete, an operational contract was signed. This set out all the requirements relating to the specific project, including the technical specifications, the price, manufacturing procedures, quality standards and delivery details. The normal length of a contract was three years, but this was not long enough to encourage suppliers to invest in new machines or new technology for the project. At the end of each contract, the supplier had to bid once again for a new project. AIR’s senior management team had previously decided to have such short contracts in order to ensure that it always worked with the lowest cost suppliers. As one senior manager (5) explained “you didn’t have any relationship with these people […] you could look for different quotations to see if you could find someone who was a bit more competitive”. However, this approach did have drawbacks. According to a purchasing manager (4), the interaction with the suppliers was along the lines of “This is what I want. Make it for me”. As a result, suppliers had little influence over the product design, and this often resulted in a mismatch between the design and the manufacturing capability of suppliers.

As is characteristic of this first phase of the SCMM, no specific performance measures were used (cf. Lockamy and McCormack, 2004), and the suppliers’ performance was only evaluated at the end of the contract – i.e. during the contract review for the next project. As such, the contract was the only formal control mechanism in place and signing the contract carried with it an expectation, underpinned by the legal protections provided in contract law, that the supplier would honour the terms of the contract. According to Sako (1992), this expectation can be described as contractual trust, and this is the minimum level of trust needed to enter into a contract. Contractual trust will be built up during the contract review process and in the negotiations which take place prior to signing a contract.

AIR’s actions illustrate that during the autonomous firm phase a company’s positive expectation of its supplier will initiate the relationship and lead to the development of contractual trust. In this early phase of the SCMM, we saw that AIR’s managers had the minimum level of trust needed to enter a contractual transaction with its suppliers. This minimum level of trust provided a positive expectation that the supplier would honour the contract – thus, contractual trust reduced the uncertainty as it was underpinned by the existing institutional arrangements and, in particular, by the legal system. In practice, the legal system underpins the contractual trust which people have in market-based transactions. The presence of a legal system reduces the risk inherent in entering into a transaction and provides the basis for a minimum level of trust between the parties. It also provides a platform upon which trust can grow (Lane and Bachmann, 1997; Luhmann, 1979). However, in this phase, the control system used to manage the supply chain was very simple – comprising just the contract. As contractual trust provided the basis for control, in this phase trust and control were complementary. Minimal trust initiated the transaction and control was underpinned by the contract. In this way, trust and control together led to uncertainty reduction.

_A milestone for change: 2004_

In 2004 a number of changes occurred in AIR, including the beginning of the restructuring of its supply chain. This restructuring had the aim of improving AIR’s supply chain performance and eventually its overall performance. Earlier, AIR’s management team had commissioned consultants to study how it (AIR) was perceived by both its customers and its suppliers, and the results were very disappointing, characterising AIR as “arrogant”. Consequently, it began restructuring its supply chains in order to put in place a new global supply chain strategy, which included a substantial reduction in the number of suppliers, identifying the major suppliers and developing close relationships with them. These actions correspond to the second phase of the SCMM – the serial dependence phase, which represents the beginning of a more collaborative relationship and a focus on actively
managing suppliers (see Berry et al., 2000). Major suppliers were identified and encouraged to invest in capacity and technology that would be beneficial for their business with AIR; this is typical of the serial dependence phase (Lamming, 1993; Lockamy and McCormack, 2004). Initially, no additional control mechanisms were introduced, but trust became more important than in the previous phase. As we will explain below, goodwill trust was a necessary condition for the identification of major suppliers and for the development of collaborative relationships with them.

It was the consultants who recommended restructuring the supply chain. They had measured the satisfaction expressed by AIR's customers and suppliers, analysed their experiences, and benchmarked both against AIR's major competitors. The consultants pointed out that both customers and suppliers were very disappointed with AIR's attitude and performance, with some suppliers indicating that they would reconsider working with AIR in the future. In view of the problems of changing suppliers in the aerospace industry, even though AIR is the dominant party in its supply chain, it had to react and improve these relationships. As a senior manager (5) explained:

We were arrogant, we were short term, rather than medium and long term, we were constantly moving products to save unit price cost, but the total cost was actually more, because you had to pay to move components, you had to support it, you had to validate it, etc [...] So we had like an alcoholic moment, we thought we were socially drinking, and we were okay, but we actually had a problem and then it was pointed out to us that we were not very good at purchasing, we were not very good at relationship management, and we were not very good at working with our supply chain.

Furthermore, suppliers also complained that their supply chain was too complicated with too many interfaces and points of contact, and this created confusion and delays. As a purchasing manager (3) pointed out:

One of the big criticisms that AIR received is that we didn't use the suppliers' expertise, knowledge and staff. On the contrary, we thought that we knew best. We were not satisfying our customers, mainly through supply chain delivery issues. Good performance didn't necessarily equal more work, etc., and so that's when a change in the focus was necessary.

Having recognised the problems, AIR's senior managers started restructuring its many and diverse supply chains. As another purchasing manager (4) explained, "we wanted to give more capabilities to the supply chain". For the first time, they had strategic intentions for their suppliers. In a later interview, the first purchasing manager (20) pointed out that:

There was a plethora of relationships, because of the number of supply choices out there [...] However, technology requirements are increasing and there's less and less people involved in it, so you have to initiate a partnership.

Having analysed the feedback from the consulting company, as well as studying the expectations of the industry's regulators, AIR's senior managers developed a new global purchasing supply chain strategy in 2004. As senior operations purchasing manager (5) explained:

[...] to drive the business forward we need a smaller number of larger strategic relationships [...] our core business is original equipment and technology, managing supply chains is just a by-product of trying to do that, so we much prefer to have these organisations [first-tier suppliers] working with the supplier chains, organising them and delivering us components [...] Now the purchasing strategic direction is to go from approximately 500 suppliers per product down to 40. So, we now have to manage and work with the suppliers that had been put under pressure in the traditional purchasing world. But that is a conscious decision and it's difficult, but that's what we didn't have.

In order to reduce the number of suppliers and to create closer relationships with fewer major (i.e. first-tier) suppliers, the new strategy was divided into three steps (see Table II).
In the first step, the priority was to rationalise the supply base by “exiting” poor performing suppliers – i.e. stopping working with them. In the second step, the focus was on developing close relationships with the major suppliers. The final step was to develop a system of integrated accountability for the major (first-tier) suppliers who, in turn, would be responsible for managing their own (second-tier, third-tier, etc.) suppliers. By reducing the number of suppliers and developing closer and better relationships with the remaining (major) suppliers, a more flexible supply chain was created, with increasing overall performance.

The identification of major (or preferred) suppliers is typical of the serial dependence phase (Lamming, 1993; Lockamy and McCormack, 2004). For AIR, a “major supplier” is not necessarily defined in terms of the frequency or volume of projects, but it is a supplier who is important for the continuity of the manufacturing process. For such suppliers it is important to have a positive expectation that they would not act opportunistically and to display an open commitment and reciprocity. As the parties communicate their intentions through relational signals, the trust which is necessary for AIR to start to work more closely with the selected suppliers, and thereby to encourage further collaboration, is gradually built. As an operations manager (9) pointed out: “we need to trust them that they won’t use the same technology with other customers”. The aim during this phase was to enter into close, long-term relationships in which the suppliers would become involved from the early stages of the design process and would share investment and technical know-how. Consequently, trust was a necessary condition in the choice of these major suppliers. As a purchasing manager (4) explained: “the existence or not of trust changed our negotiation strategy – meaning our willingness to share more or less information with them”. Thus, the chosen suppliers must have a moral commitment to the maintenance of the relationship, be willing to offer help when it is needed, and not take unfair advantage of any situation that may arise[6]. As such, trust is seen as a “cognitive state that generates positive expectations of the abilities, intentions and integrity of the other” (van der Meer-Kooistra and Vosselman, 2010, p. 94).

AIR’s actions in this phase illustrate that goodwill trust provides a platform upon which collaboration can be built and facilitates the implementation of (initial) control mechanisms. AIR reduced the number of its suppliers and continued working only with those suppliers which its managers thought likely to possess the motivation and capabilities needed to develop a collaborative relationship. So, goodwill trust was needed to initiate closer collaborative relationships. In this phase, in AIR, we did not see the implementation of additional control mechanisms to safeguard behaviour (i.e. in addition to the contract). In other words, although goodwill trust facilitated the initiation and development of collaborative relationships, it was not until the next phase that additional control mechanisms were introduced – as we will see below. In the current phase, trust was built and this facilitated closer collaboration, but as there were no additional control mechanisms beyond the contract, trust acted in place of (i.e. as a substitute for) control. As such, trust and control can be seen as a dualism. However, this may be due to the way we present our case study findings, as there is no unambiguous distinction between the different phases.

<table>
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<tr>
<th>Step 1</th>
<th>Rationalise supply base</th>
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<tr>
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<td>Exit poor suppliers</td>
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<td>Step 2</td>
<td>Develop relationships across the supply chain with major suppliers</td>
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<td></td>
<td>Develop capable low cost sources</td>
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<td></td>
<td>Selectively delegate supply chain management responsibility</td>
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<tr>
<td>Step 3</td>
<td>Develop an integrated system/module of accountability for major suppliers</td>
</tr>
</tbody>
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Source: AIR’s investor presentation – internal documents

Table II. Global purchasing supply chain strategy
Restructuring of the supply chain: 2004-2006

As we saw above, in 2004 the supply chain restructuring began with the development of a new global supply chain strategy. Initially, the number of suppliers was reduced significantly, and then AIR's managers developed much closer and longer-term relationships with those that were retained. During the subsequent couple of years, AIR continued to implement its supply chain strategy by introducing new initiatives. First, it entered into long-term agreements (LTAs) with its external suppliers, and second it made a number of changes to the management of its JVs. The actions taken by AIR during 2004-2006 fit the reciprocal dependence phase of the SCMM (see Berry et al., 2000). The focus was on increasing collaboration with preferred suppliers, which is characteristic of the reciprocal dependence phase (see Lamming, 1993). Furthermore, in this phase, there is typically more information sharing across organisational boundaries and cross-organisational teams are formed to manage the supply chain. AIR’s senior managers introduced new performance measures into the JVs and they initiated continuous improvement programmes – actions which again are typical of the reciprocal dependence phase (see Lockamy and McCormack, 2004). In this phase, control and trust become interactive. During this phase, the strengthening of goodwill trust facilitates the implementation of new control mechanisms, which in turn support the development of competence trust – as will be described below.

By working more closely with its major suppliers, AIR was seeking to take advantage of their expertise and to promote supplier involvement in the early design stages. As the traditional arm’s length relationships were no longer suitable, AIR signed LTAs with its major suppliers, typically with an average life of ten years. The LTAs provided legal protection to both sides and were the contractual basis for close long-term collaboration. During the period covered by an LTA, AIR and the supplier could collaborate on several projects and share knowledge, technology and the procurement of raw materials. For each project, a separate operational contract would be signed between AIR and the supplier[7]. In this reciprocal dependence phase, the character of the projects and the context in which they were allocated changed. In the earlier phases, the projects were quite separate and independent, but in this phase a project was generally just one element within an LTA. Whereas previously the (operational) contracts were used to control the projects and to provide the legal basis for the relationships between AIR and its suppliers, in this phase the operational contract was used to set out the specifications for individual projects, while the LTA was used to control the long-term relationships. As individual suppliers typically had more than one operational contract, there was a need to develop new control mechanisms to manage these relationships. During this phase, a new “suite” of contracts emerged, comprising an “early supply” contract and a non-disclosure agreement. However, despite the use of these new contracts to safeguard behaviour, trust was still important. As a purchasing manager (14) explained:

The non-disclosure agreement offers the legal protection. We do a lot of them. But practically if they [the suppliers] want to disclose it, they can. And there is nothing you can do to stop it. You just have to trust them. That’s another reason why I need to develop better relationships with our suppliers, so they won’t get annoyed and tell our competitors our practices.

By entering into LTAs, the aim was to create an environment which would promote collaboration and reduce the uncertainty and lack of security that suppliers had complained about in their earlier responses to the consultants – mentioned above. The suppliers could now begin to see the future of their relationship with AIR and the potential for further work to be allocated to them. In our interviews within AIR, carried out in late 2006 and early 2007, interviewees talked about “relationship values”, and although there was no explicit discussion of trust, expressions like “credibility”, “openness” and “being able to rely on someone”
were used. After entering into LTAs, suppliers were more willing to invest in technology, facilities and people because of the commitment of AIR and the longer-term contracts that they had signed. As both parties were working more closely together over rather longer periods, they developed a joint vision and a familiarity with each other that strengthened goodwill trust. As senior operations purchasing manager (5) explained:

High technology industries, such as the aerospace industry, normally need significant investment. So when our suppliers need to borrow money to buy new machines, or new facilities, they need to give to their banks a longer justification. So you [AIR] then have to make a very balanced decision between: do you do very short-term tactical purchase orders; or do you build for the longer, more stable future, and have a trusting relationship that says that you will work with these suppliers to make sure they’re low [cost], and they’re very competitive.

This closer collaboration with suppliers created the need for more information to be available before operational contracts were signed. In addition to the cost, quality and delivery issues were discussed during the contract review process[8], AIR started to perform SWOT[9] analyses to gather information about the suppliers' technological capabilities and capacity to perform the project, the availability of the required materials, and the related risks. Furthermore, subjective criteria such as confidentiality, management attitude, ability to manage lower-tier suppliers and financial viability (through a financial assessment of the supplier) were all discussed before operational contracts were signed. As a purchasing manager (4) explained:

Before we source a project to a supplier, we go through a contract review process, where we invite key stakeholders and we present what the Purchasing view is […] we are looking at a supplier and we ask the Supplier Intelligence Team to do a financial health check on them. If someone comes back as red then that means that we won’t source to him.

Even though the information gathered through the contract review process was potentially quite sensitive (according to our interviewees), the suppliers were willing to disclose this information. This willingness is probably due to goodwill trust which was stronger during this phase because of the close collaboration between AIR and the suppliers. With the exception of the financial assessment, this information was monitored annually to identify any changes in the suppliers’ situation. Having this information meant that AIR’s team was able to assess the suppliers’ capabilities to perform their allocated projects. Thus, this additional information enabled AIR’s managers to build competence trust in the suppliers, i.e. trust that the suppliers have the capabilities necessary to perform satisfactorily the tasks allocated to them (Sako, 1992). It seems here that there is a complementary relationship between trust and control, where control builds trust, and in particular competence trust.

A significant element of the supply chain restructuring process during this phase focussed on the JVs. Until that time, there had been limited interaction between AIR and the JVs, partly due to the geographical distance between them, and all the JVs had been reporting losses. When AIR became more involved during this phase, its immediate aim was not only to improve the JVs’ financial positions, but also to change their manufacturing and strategic goals. Consequently, initially the focus was on the way the JVs were managed as entities, rather than specifically focussing on their operational contracts. The JVs needed to have a strategic focus/orientation, and to recognise that a balanced approach, combining performance effectiveness and high quality products, could be profitable and secure their long-term success by meeting their customers’ requirements. To achieve this, management teams in AIR began to have a much closer involvement in the JVs; developing mutual interests through more frequent interactions with AIR, and support from AIR’s own staff when needed, thereby working much more closely together despite the physical distances. As a financial controller (6) explained: “they [the JVs] now take a lot of our best people, business methods engineers; they all go out to those places [the JV sites] to help them”. 

Inter-organisational relationships
Transparency was further improved as the JVs started to become involved in the early design and manufacturing stages. These changes improved the relationship between the teams in both parties and led to the development of goodwill trust. Improved personal relationships, together with goodwill trust, was seen as crucial for the management of the JVs. As a senior manager (13) pointed out:

You have to have trust. Both the management team and the shareholders spent time and effort to try to make sure that both parties are aware of things. You have to have good trust, from the Board level to the General Manager, to the people actually supporting it and looking after the JV. If trust breaks down, then you start getting problems.

Goodwill trust was particularly important where there was distance between the parties. For example, in one of the JVs, where the Chinese Government owned the majority of the equity, language barriers and cultural distance created many problems in the day-to-day operations of the business. As a financial controller (6) illustrated:

We had to build a lot of trust between ourselves. They [the JV] were extremely secretive in what they do and it was quite hard to get information out of them. For example, they had the tendency not to speak English when it suited them. So it required a lot of bridge-building to get to a level of understanding and trust. But once we got that, they were very good in providing information to us and we only had to ask them once. They are very quick and responsive now.

During this phase, AIR’s managers saw the JVs as a way of developing their own ideas and processes, and in particular as a way of learning and testing the supply chain restructuring process. They introduced new control mechanisms for monitoring supply chain performance into the JVs first, before extending them to the external suppliers. As a manager (7) responsible for JVs explained:

The idea originally was to pilot it with the JVs and then any mistakes and any learning points [...] we could then take them and work with the other suppliers. It wasn’t because we wanted to do the JVs first, other than the fact that you don’t wash your dirty laundry in public. You want to make mistakes with someone in house and then you can learn from them and then take it to others. That’s just the reality.

The intention was to improve the control of the JVs through the application of AIR’s domestic measures, i.e. its financial and operational key performance indicators (KPIs) (see Table III). All the JVs had to submit a monthly business review pack which included these KPIs, together with reviews of sales and marketing operations, together with an income statement and a statement of financial position. One result of this process was an improvement in the JVs’ performance and consequently in their profitability. This frequent flow of information helped to overcome obstacles related to the physical distance between the partners. Furthermore, there was increased assurance that the JVs had the required capabilities to perform their allocated projects. Thus, this information helped to build competence trust in the JVs. As the financial director for operations (13) explained:

What really made me apply the KPIs to the JVs was to provide a strategic focus – to try actually to realign what they are making with what they should be making in accordance to AIR’s strategy for that JV.

A senior purchasing manager (12) commented on the benefits of applying the new control mechanisms to the JVs as follows:

That focus has allowed us to move the P&L [income statement] in the right direction because we can see excess inventory or sales. The profit increased and people there had a better understanding of what they are doing.

Getting the JVs to accept and implement the new control mechanisms was not straightforward; as such controls were not part of the JV agreements. Consequently, the JVs’
management teams and the other parents had to be persuaded of the benefits of using these control mechanisms. Because of their poor performance, and also the previous lack of proper management support from AIR, the JVs did not initially trust AIR, and there was a concern that, although the new control mechanisms might benefit AIR, they might not be beneficial for the JVs themselves. Thus, goodwill trust was needed – i.e. trust that AIR was not acting opportunistically – for the JVs to accept and implement the new control mechanisms. However, over time AIR managers were able to persuade the JV managers that these control mechanisms would improve the performance. As goodwill trust started to develop between individuals from the JVs and AIR, managers of the JV became more willing to supply the information to AIR and also to use AIR’s KPIs to control their own operations[10].

As a senior manager (13) pointed out:

I don’t think we had to force the KPIs on any JV. I think that was because we managed to persuade them that this is a mix that makes sense, it’s a balanced scorecard approach. Also, because they trusted us, because we are a big manufacturing company, they expected us to have the best practices […] Now the KPIs are always displayed on their notice boards.

AIR’s actions in the reciprocal dependence phase illustrate the complex complementary relationship between trust and control, where trust builds control and control builds trust. The increasing collaboration strengthened goodwill trust between the partners. The development of goodwill trust between AIR and its suppliers facilitated the implementation of additional control mechanisms, and subsequently the implementation of these control mechanisms built competence trust. In this reciprocal dependence phase, collaboration became more intense as AIR entered into LTAs with its major suppliers. With these longer-term agreements in place suppliers gained confidence in their relationships with AIR, and consequently they were willing to invest in new technology, facilities and people. More frequent interaction created familiarity and empathy, which in turn strengthened goodwill trust. This goodwill trust made suppliers willing to disclose sensitive information and facilitated the use of additional control mechanisms (initially in the JVs). The additional information gathered through the contract review process, such as information about the suppliers’ technical

<table>
<thead>
<tr>
<th>Operational KPIs</th>
<th>Financial KPIs</th>
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<tr>
<td>Cost</td>
<td>Profit and Loss</td>
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<tr>
<td>Productivity</td>
<td>Sales</td>
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<td>Throughput per hour</td>
<td>Gross margin</td>
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<td>Net sales per hour</td>
<td>Working capital</td>
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<td>Operating costs</td>
<td>Cost rate</td>
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<tr>
<td>Quality</td>
<td>Operating costs</td>
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<tr>
<td>Scrap</td>
<td>Head count</td>
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<tr>
<td>PPM(^e) concessions</td>
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<tr>
<td>PPM defective</td>
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<td>Customer incidents</td>
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<td>Delivery</td>
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<td>Schedule Adherence</td>
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<td>Total Arrears</td>
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<td>Lead time Adherence</td>
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<td>Yield</td>
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<td>Days arrears</td>
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<td>Longest output arrear</td>
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<td>Inventory</td>
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<td>Net Inventory</td>
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**Note:** PPM stands for parts per million

**Source:** Internal documents

Table III. Key performance indicators for the joint ventures
capabilities and financial situation, led to the development of competence trust. In this way, the additional control mechanisms provided the information needed to maintain and further develop trust. Previously, AIR’s managers had only been concerned about the suppliers’ ability to meet the terms of the individual contracts. Now, however, they were interested in the suppliers’ broader competences to contribute to the performance of the supply chain. Moreover, competence trust in the JVs was further developed through the monthly financial and operational data which the JVs provided. The above discussion illustrates the duality of trust and control in the reciprocal dependence phase, where the one cannot exist without the other. Goodwill trust enables additional controls to be implemented and those controls help to build competence trust as the relationships develop.

**Final changes: 2006 – onwards**

Having completed the initial steps in the implementation of its new global supply chain strategy (see Table II), AIR began the final step in 2006, with the development of an integrated system of accountability for its major suppliers. This included formalising procedures for the procurement of commodities and the management of suppliers. Collaboration with suppliers had by then already been established and the focus of attention shifted to the development of a partnership model and to the governance of the relationship. AIR’s actions during this period are in line with the final phase of the SCMM – the mutual dependence phase (see Berry *et al.*, 2000). This partnership model sought to identify mutual interests and establish mutual respect between AIR and its suppliers (cf. Lamming, 1993). Furthermore, advanced supply chain management practices, which transfer responsibility without legal ownership (Lockamy and McCormack, 2004), were put in place. AIR introduced a range of control and performance measurement mechanisms, including a supplier scorecard and a relationship profile tool. These mechanisms not only generated technical information, which increases competence trust, but also developed “soft elements”, such as mutual respect, common values and long-term integrity, which strengthen goodwill trust and contribute to the continuity of the relationship.

AIR’s new supply chain strategy now provides clearly defined and well documented procedures for the management of relationships with its suppliers and for the procurement of raw materials and intermediate commodities. These procedures are divided into two parts: the development of commodity strategies and the development of supplier strategies. The commodity strategy, which replaces the previous purchasing policy, plans the procurement of each commodity for the next ten years, i.e. the procurement of raw materials, components, services, etc. Amongst other things, the commodity strategy includes the make-buy decision for each commodity and identifies potential suppliers when the decision is to “buy” – i.e. to allocate projects to suppliers.

With a commodity strategy in place, the supplier strategy is developed jointly by AIR and its supplier(s). It seeks to align the strategies of both parties in order to identify, develop and deliver the long-term business objectives of both. By promoting the early involvement of suppliers, issues related to the supplier’s capabilities and available technology, facilities and people can be addressed. Where necessary technology can be shared and agreements made about new investments required to provide the capacity needed to meet AIR’s requirements. By jointly developing the supplier strategy, the suppliers feel valued by, and committed to, AIR. This has a positive impact on goodwill trust between the partners, and it further strengthens the competence trust that AIR’s managers have in its suppliers. As such, this mechanism signals trustworthiness between the partners. As a finance manager (7) explained:

> The supplier strategy is something that we say we want from the supplier and they say they want from the customer [AIR][…] then we get together and we agree a joint vision for the next 10 years […] Does the supplier have the capability to deliver? What do they need to do? What technology, facilities, training or personnel [are needed] to get that capability?
Following the successful introduction of new control mechanisms for the JVs (described in the previous section), similar control mechanisms were extended to all the suppliers; specifically, a quality control system, a supplier scorecard, target costing and a relationship profile tool. The quality control system, which is termed the Supplier Advanced Business Relationship (SABRe), is intended to support the relationships and to develop mutual commitment. This is now an important tool for AIR since, as the final assembler, it is responsible for the overall performance of its final product. SABRe sets out the business requirements for suppliers in terms of four measures, which AIR benchmarks against other suppliers, namely quality, cost, delivery and responsiveness. These requirements are regularly discussed with suppliers and their achievements are recorded on the supplier scorecard (see Table IV). A scorecard is constructed for every supplier when its supplier strategy is designed, and it is updated every six months. According to our interviewees, the suppliers are willing to disclose the required information because of the close collaboration they now have—in other words, because of the goodwill trust which now exists between them. When necessary, AIR will work with suppliers to improve their performance. The regular discussions of the supplier scorecards are a two-way process. As a senior purchasing manager (12) explained: “[...] we start by listening to the supplier and we will go through what is important for them first”. This enables suppliers to discuss openly their concerns and issues with AIR. As such, the supplier scorecards can help to reinforce (or otherwise) the belief that the suppliers continue to have the capabilities needed to perform satisfactorily the projects which are allocated to them. Thus, this mechanism contributes to the development of competence trust which supports the continuity of the relationship.

The early involvement of suppliers, as well as the creation of partnerships with suppliers, led to the recognition that AIR’s cost management techniques needed improvement. As the financial director of operations (13) commented: “I think that AIR was traditionally naïve in managing cost and now we are looking at it very seriously”. The involvement of suppliers in the early stages of the design and manufacture of components has enabled target costing to be introduced. The discussion now starts from the expected selling price and AIR’s finance and procurement teams work with the suppliers to build agreed target costs. The process of building target costs has improved communication and information flows at both the cross-functional and the cross-organisational levels. Having target costs in place, which are developed jointly with the suppliers, gives AIR much greater control over suppliers’ costs and enables it to form realistic expectations about whether suppliers can meet the agreed price. This, in turn, helps to strengthen competence trust. Furthermore, as the approach taken in these control mechanisms is to ensure that the suppliers’ interests are being achieved, goodwill trust is also enhanced.

| Quality         | Delivered quality PPM* |
|                | Delivered quality concessions |
|                | PPM                        |
|                | Delivered quality (occurrences) |
|                | Concessions (occurrences)   |
|                | Customer complaints         |
|                | Schedule adherence          |
|                | Delivery performance        |
|                | Total days late             |
|                | Total schedule lines missed  |
|                | Cost of non-quality         |

**Note:** *PPM stands for parts per million*

**Source:** Internal documents

**Table IV.**
Suppliers' scorecard: key performance indicators
In this mutual dependence phase, AIR’s managers seek to develop supportive, mutually committed relationships (cf. Berry et al., 2000). To promote long-term partnerships with its suppliers, the focus is on encouraging two-way communication in order to improve transparency and to build confidence in each other. To do this there is a need to look beyond the traditional technical measures (such as cost, quality and delivery) and to give attention to such soft elements as mutual respect, common values, long-term integrity and so on (as mentioned earlier). However, the expression “soft elements” was not used by the interviewees in AIR; instead, some used the more light hearted expression “pink and fluffy”. As a senior purchasing manager (12) explained:

[...] to get a better long-term view, the characteristics we need to focus on are not always price, not always quality, not always delivery; but the relationship value is one of the assets we needed to be more focused on [...] I think it has to be done in a measured way because a lot of the importance of the collaboration is to have a strong relationship and it takes time to set that up [...] You formulate relationships by doing work outside of the day-to-day transactional side [...] what I call “pink and fluffy”. When we arrange a meeting I want for the first hour to talk about our relationship, about our common values. While my supply chain manager argued that no, we need to tell them to improve their deliveries, etc. I disagree with him. I am going to have a pink and fluffy session; we need to bring the teams together [...] working on the relationship to get an openness to say what your values are. I could show you statistically that the delivery was linked to relationship management, rather than the transactional side.

Nevertheless, building good personal relationships between the people involved is not sufficient on its own for the successful governance of the relationships in the long term as the aerospace industry is characterised by high staff turnover. There is always the possibility that the benefits of good inter-personal relationships will be lost in the handover when someone leaves. The same senior purchasing manager (12) argued that there is a need for a more “detailed structure”. Reflecting on a conversation he had with a colleague, he explained:

Well how have we done that? What’s the structure? He’ll just say that it’s his personal energy, that it’s his personal way of driving issues, that it’s his networking with senior people within AIR. So when you go, what happens? And he’ll say “oh well, maybe somebody else will pick it up”. But it is within my portfolio now, but where’s the governance structure, where’s the protocols, where’s the framework for management? He says, “well, I’ll take you out, I’ll introduce you to them”. So I think we have relied on very good individuals to generate direction, and their personal energies to increase performance, but what we haven’t been very good at, until now, is putting in rigour, structure and a framework.

Consequently, senior managers have attempted to build a structure to promote the openness, honesty and trust that good personal relationships require. With the help of consultants, the relationship profile tool was developed. This tool seeks to set out the structures upon which a good relationship can be built, independently of the specific individuals involved. As a purchasing manager (20) explained:

The first pilot was done with a big supplier with a really problematic relationship. That was one reason. And also, we didn’t want any bias from our end. We had a completely neutral, independent person and they [the external consultant] produced a series of reports, some on what the supplier sees that we don’t see, and some on what we see that the supplier doesn’t see, and then a de-sensitisation that everyone sees and goes in, and they [the consultants] basically decided if it’s a strategic match. Then we’ve got our version, which we don’t have to pay for. So with little suppliers we’ve got basically what we did with the external consultants, a shortened version, but if it’s a big spend we’ll go halves with the supplier.

So the relationship profile tool was initially developed to improve a poor relationship with a major supplier, but when managers realised its benefits, the tool was introduced across the whole supply chain. The relationship profile tool is completed jointly by AIR and the supplier,
and provides an opportunity for both parties to identify problematic issues and together decide on improvement plans. It is more complex and more sophisticated than the supplier scorecard, mainly because it focuses on the social aspects of the relationship, which are difficult to quantify. It addresses such soft elements as mutual respect and mutual benefit, transparent processes, collaboration, trustworthiness, relationship management, long-term integrity and two-way communication (Table V illustrates the categories). This tool gives an objective measure which states quantifiably what the relationship with a supplier is like. Each partner knows what to expect from the other, and through continuing interaction they try to achieve these expectations. Each party seeks to understand and document the other party’s needs and expectations. By doing so, the relationship profile tool is intended to help maintain these relationships when someone from either party leaves. As such, the relationship profile tool aims to remove the uncertainty and to accelerate the process of developing inter-personal trust between the new people. By documenting experiences, the relationship profile tool sets out clear expectations. As a purchasing manager (20) commented:

This tool gives an objective measure that says quantifiably what our relationship [with the supplier] is like. So someone might say that he has a cracking relationship with Supplier A, whom he deals with and I might be dealing with a different person [from that supplier] and have a rubbish relationship. So, someone says to the client “What’s your relationship like with Supplier A?” “Brilliant”; me, “Rubbish”. So you need an objective measure. What’s your relationship like with Supplier A? Well according to the profiling tool I’ve got this percent, because here’s a document that says quantifiably what our relationship is like.

The relationship profile tool comprises an actual score and a desired score on a 1-4 scale, where 1 reflects least integration of the two parties and 4 the most. There is space for creativity – i.e. flexibility – in this category. AIR and the suppliers agree on the principles and the desired score, so they each develop their ways of working together. In cases where the desired state of the relationship is not achieved, immediate action can be taken to improve the relationship. So for example, if the two partners decide that the relationship currently scores 2 regarding their long-term integrity, whilst the desired score is 4 (see Table VI), they will draw up an action plan setting out what is needed to improve the problematic areas. This will then be followed by six-monthly reviews to verify that the improvement plans are being implemented.

The relationship profile tool seeks to harmonise expectations and to support interactions by providing guidelines for recognising necessary actions and evaluating their results. The aim is to provide the stability and standardisation which are necessary to give some protection against breakdowns in trust. It provides a template for building and maintaining trust, and thereby enables trust to persist across groups and over time.

AIR’s actions in the mutual dependence phase reveal the implementation of mechanisms that aim to promote communication and to signal trustworthiness. The development of trust is affected by the partners’ abilities to “read” each other and to signal trustworthiness (Carson et al., 2003; Vosselman and van der Meer-Kooistra, 2009). This can be seen

| Mutual respect and mutual benefit | All interactions with AIR reinforce mutual benefit and respect. Supplier’s capabilities are fully understood and utilised |
| Clear purpose and transparent processes | Mutual objectives are fully understood |
| Collaboration | AIR and supplier jointly resolve issues, seek to develop and improve together |
| Capable empowered joint teams | Clear understanding of responsibilities and processes for each role |
| 2-way communication | Communication from both sides is effective and covers needs |
| Act with long-term integrity | Trust and honesty characterise the relationship, problems are shared, no opportunistic behaviour |

**Source:** Internal documents

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**Inter-organisational relationships**

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**Table V.** Categories included in the relationship profile tool
particularly in the development of the relationship profile tool. The control mechanisms which have been implemented generate the information required to strengthen competence trust and thereby contribute to the continuity of the relationship. These control mechanisms have led to more sharing of information (including accounting, technical and operational information). The goodwill trust, which was built up in the earlier phases, can explain the willingness of suppliers to share this information and also the successful implementation of the new control mechanisms. These control mechanisms, e.g. the supplier scorecard and target costing, have allowed managers within AIR to strengthen competence trust in its suppliers. Furthermore, both the supplier strategy and the relationship profile tool have strengthened goodwill trust and maintained good relationships with suppliers, even after individuals directly involved in the relationship have left. In the mutual dependence phase, as in the previous phase, we can see the duality of trust and control, as existing goodwill trust facilitates the use of additional control mechanisms, which in turn further strengthen competence trust. So, in this context additional controls do not damage trust, rather they strengthen it and contribute to the continuity of the relationship.

5. Discussion
In this paper, we have shown that the relationship between trust and control changed over time, specifically as the studied organisation moved through the different phases of its supply chain restructuring. Furthermore, we noted a shift in the relationship between trust and control from a dualism to a duality as the supply chain matured. In the early phases of the SCMM, the relationship between trust and control was relatively simple and straightforward. However, as the supply chain moved into the more mature phases, the relationships became more complex, and trust and control seemed to inevitably become more interconnected, interactive and reflective – a duality. Looking at AIR’s supply chain before it was restructured, a minimum level of trust was needed for a transaction (Arrow, 1974) – i.e. what Nooteboom (2002) calls thin trust – and the use of the contract as a control mechanism led to the development of contractual trust (Sako, 1992). Hence, trust and control were complements, and the relationship between trust and control could be characterised as a dualism[11]. As the supply chain restructuring got underway and there were increasing interactions between AIR and its suppliers, goodwill trust developed and this facilitated the implementation of other control mechanisms, beyond the contract. As the collaboration became more intense and the relationship more important to the partners, goodwill trust was not sufficient on its own and additional control mechanisms were needed.
both to promote further collaboration and to safeguard behaviour. Here, we saw the role of control, not only in monitoring and safeguarding behaviour (as the contract does), but also in producing the information needed to promote further collaboration and commitment, and subsequently to enhance trust. Over time, familiarity and collaboration strengthened goodwill trust, and facilitated the implementation of new control mechanisms, such as the supplier strategy, the supplier scorecards, target costing techniques and the relationship profile tool. The information generated by these mechanisms further developed competence trust (Sako, 1992). As such, trust builds control and control builds trust (Vosselman and van der Meer-Kooistra, 2009). The duality means that trust assumes the existence of control and control assumes the existence of trust, and furthermore it is not feasible to have one without the other (Möllering, 2005).

It is well documented that organisations cannot trust, but individuals who are members of an organisation can trust other “individuals, organisations, institutions and systems” (Nooteboom, 2002, p. 8). Inter-organisational trust describes “the extent to which organisational members have a collectively held trust orientation towards the partner firm, which is quite different from saying that organisations trust each other” (Zaheer et al., 1998, p. 143). As such, inter-organisational trust is held at the individual level, but individuals can be trusted because they work for a particular organisation – not as individuals per se. If they move from that organisation they will not necessarily continue to be trusted. Our findings document a distinct attempt to move from inter-personal trust relationships to inter-organisational trust relationships. We observed an attempt to disembed trustworthiness from the individual relationships and to maintain trust over the long periods of time which are involved in the development of partnerships. By doing so, AIR hopes to secure the benefits of a trusting relationship despite personnel changes. A shift from inter-personal to inter-organisational trust can occur if the representative’s conduct is viewed as typical of the organisation’s conduct (Doney and Cannon, 1997). Kroeger (2011) observed similar behaviours in the UK book publishing industry, where a group of managers reduced their reliance on traditional individualised inter-personal relationships (between editor and author for example) by creating a more formalised approach to trust building. He questioned whether the organisation as an entity can be the subject of trust (p. 8), and concluded that “the organisation, as a distinguishable entity, will only be truly consequential as a subject of trust if there is a degree of stability in the way action is organised over time” (p. 9).

Nevertheless, we do not see an organisation as a subject, but as an object of trust. In AIR, we saw the development of the relationship profile tool as a formalised approach to trust building which facilitates the development of an impersonal and quantified form of trust. The relationship profile tool seeks to maintain trust as specific individuals come and go, but nevertheless aims to retain trust at an individual level. As discussed above, inter-organisational trust remains at the individual level. Our findings indicate that it was the lack of consistency and structure that led to the development of the relationship profile tool. This might have been particularly intense in AIR because of high staff turnover, geographical distance, and the complex supply chain. The relationship profile tool aimed to achieve consistency and standardisation across the entire supply chain.

The approach that we have adopted in this paper does not distinguish between the different partners, as the supply chain as a whole was the unit of analysis. Nevertheless, we need to acknowledge that not all members of the supply chain achieve the same levels of individual or organisational trust due to, among others constraints, their geographical distance. Geographical proximity of firms can encourage the development of inter-organisational trust due to frequent face-to-face communication (Dyer and Chu, 2000; Lane and Bachmann, 1998). Still, organisations may trust their most important partners irrespectively of where the partners are located due to the many and
repeated transactions between them (Bönte, 2008). In the case of AIR, the attempt to formalise trust building through the use of the relationship profile tool was prompted, not only by the desire to maintain trust despite high levels of staff turnover, but also to overcome the obstacles posed by geographical distance.

A further point to note is that control mechanisms can fulfil a dual role. In AIR, the control mechanisms were used not only to constrain (or safeguard) behaviour, but also to facilitate collaboration and contribute to the continuity of the relationship. Before AIR’s supply chain restructuring, its control system was quite simple, with the contract the only mechanism used to constrain behaviour. However, as AIR moved through the various phases of its supply chain restructuring, the constraining role of the control mechanism(s) became less important and, instead, control was used to jointly enable the parties to contribute to the relationship. In the later phases, the contract (and possibly other control mechanisms) continued to act as a constraining mechanism(s), but other controls also acted as enabling/facilitating mechanisms.

In this paper, we have drawn upon the SCMM of Berry et al. (2000) to analyse our case. However, there are some notable differences between AIR’s supply chain, particularly in the mutual dependence phase, and the SCMM. According to Berry et al. (2000), in the mutual dependence phase there is a “partnership” between the parties (i.e. between the supplier and the buyer), as both have equal power. In this phase, even though AIR emphasised their mutual interests and involved its suppliers in the product design and the early development stages of manufacturing, AIR nevertheless retained a dominant role in the relationship. Although there was collaboration, and the character of the relationships with its suppliers had changed, AIR remained in control and set the boundaries. So, even though the suppliers are more involved in the process, it is a process that is largely controlled by AIR. There are important institutional reasons for this – especially given the nature of the industry. AIR is responsible for the final products and is accountable to customers, governments and the general public. If there are problems in its supply chain, which lead to defects in its products, AIR has to deal with the economic and social consequences, and these could include criminal as well as civil legal action, commercial penalties and loss of reputation. Consequently, controlling quality is crucial for AIR. As such, there cannot be an equal partnership between AIR and its suppliers. Although Berry et al. (2000) developed their SCMM from a study in the UK manufacturing industry, the mutual dependence phase may not, in all cases, take the form of the partnership model which they describe. Such a partnership may be impossible in the aerospace industry or in other industries where there are similar levels of social responsibility. For example, BP, the oil multinational, recently faced massive financial and social consequences due to the pollution caused by its oil exploration activities off the US coast; activities in which there was significant involvement of its suppliers. As the final assembler or producer remains liable for the outcomes of its supply chain, there cannot be a full partnership with suppliers in the form suggested by Berry et al. (2000). Nevertheless, the essential character of the mutual dependence phase of the SCMM still applies and there will be very close collaboration with suppliers, as we saw in AIR.

6. Concluding remarks
In Section 2, we reviewed studies which have explored the relationship between trust and control, and concluded that the findings are ambiguous and remain open to debate (Vélez et al., 2008). For example, should trust and control be viewed as a dualism or a duality (see Khodyakov, 2007; Möllering, 2005)? However, we pointed out that there have been relatively few studies which have examined how the relationship between trust and control shifts over time, especially as levels of collaboration increase. In this paper, drawing on the SCMM (such as Berry et al., 2000; Cullen and Meira, 2010; Lamming, 1993; Lockamy and McCormack, 2004), we show that in the early phases of supply chain restructuring the
relationship between trust and control could be characterised as a dualism. Initially, there is a complementary relationship in the autonomous firm phase and this evolves into a supplementary relationship in the serial dependence phase. However, in the later, more mature, phases the relationship between trust and control becomes a duality, as increasing collaboration between the parties leads to the emergence of more complex interactions between trust and control during the reciprocal dependence and the mutual dependence phases.

Whereas many previous studies have examined the relationship between trust and control from a rather static perspective (Coletti et al., 2005; Das and Teng, 2002), by studying a case of supply chain restructuring in this paper we have seen that the relationship between trust and control can shift over time as the supply chain matures. This enables us to contribute to the trust/control literature in several ways. We show how the studied company endeavoured to cope with the complexity of the duality of trust and control as collaboration with its suppliers increased. In particular, we identified control mechanisms that the company developed to manage this complexity, for example, the supplier strategy and the relationship profile tool. Furthermore, we illustrated how this led to a move from inter-personal trust to inter-organisational trust (as conceived above), and discussed how in this case the supply chain managers intervened to maintain and stabilise trust by reducing the uncertainty that can be triggered by the high staff turnover in the aerospace industry.

AIR’s efforts to move from inter-personal trust to inter-organisational trust raises two practical issues. First, AIR’s managers introduced a formalised approach to trust, with the aim of achieving consistency and standardisation, as they had frequently to rebuild trust relations due to high levels of staff turnover. After restructuring its supply chain, building and maintaining trust was crucial for AIR, and having to rebuild trust each time relevant staff left either AIR or its suppliers was a difficult and time consuming task. This is unlikely to be a problem which is unique to AIR. In other companies where trust is important in inter-organisational relationship, rebuilding (inter-personal) trust when staff leave is also likely to be a problem. The relationship profile tool which was developed in AIR was one attempt to overcome this problem by providing a mechanism through which partners could monitor, repair or rebuild trust on an ongoing basis. Further research into how other organisations attempt to maintain and standardise trust, and whether they have developed similar or other such mechanisms, could provide practical insights into this issue.

Second, the relationship profile tool also identifies where interventions are needed to ensure that trust is maintained, or to repair it where necessary. Vlaar et al. (2007) pointed out that we do not know much about how managers can intervene to ensure that trust and control do not degrade (or escalate) beyond desirable levels. Studying such interventions could enhance our understanding of the evolution of trust and control, as “very low levels of trust and very high levels of distrust have a negative effect on inter-organizational performance” (Vlaar et al., 2007, p. 415). The relationship profile tool monitors the “achieved” level of trust and indicates where interventions are required if the desired level of trust in the inter-organisational relationship has not been achieved. The relationship profile tool aims to maintain the achieved/desired levels of trust and, as such, it is a control mechanism which provides for the maintenance of trust.

In this paper, we have studied the restructuring of a supply chain from the perspective of the assembler of the final product, namely AIR. This provides a one-sided perspective of supply chain management and of the relationship between trust and control over time. Unfortunately, interviewing the other parties was not possible in this research (due to access difficulties). However, supply chain management is a very important activity for an assembler, such as AIR, and it is an activity that many such companies are currently restructuring. In this paper, we have been able to study in-depth the way in which one assembler restructured its supply chain. However, it has to be acknowledged that it would have been better if it had been possible to interview all the other parties involved in the supply chain.
Future research could investigate such supply chain restructuring from the perspective of those other parties (i.e. the suppliers) and/or study the supply chain as part of a network of relationships. A second limitation of this paper relates to the company/industry we investigated. AIR has some specific characteristics, which may not be common in other companies or industries, as it operates in a highly regulated industry. However, nowadays many hi-tech manufacturing industries have quality standards imposed by non-governmental and consumer organisations. Furthermore, AIR, because of its position as the final assembler, has significant bargaining power over its suppliers. Therefore, our specific findings are contextual and may not be characteristic of supply chains more generally. Nevertheless, as we indicated earlier, we would make a theoretical generalisation, whereby the social processes surrounding the trust/control nexus, which we have studied in this paper, are likely to be applicable in other supply chains and that the theoretical insights we have gained in this study are thereby transferable to other settings.

In future studies of the development of inter-organisational relationships, we would suggest that there should be two distinct levels of analysis: the development of inter-organisational relationships as the relationships/supply chains mature and the development of inter-organisational relationships within mature supply chains, e.g. where new suppliers are added to supply chains which are already mature. In this paper, we have studied the former, i.e. the restructuring of an existing supply chain. However, there is also a need for research which examines the processes, and in particular the relationship between trust and control, as new suppliers are added to an already mature supply chain. In such a supply chain, where there will be mutual dependence between the existing parties, an important question is how a new supplier can be added? Does it have to go through the various phases of the SCMM, or are there other processes through which trust can be built, and what is the relationship between trust and control in such processes? Such research would complement the research reported in this paper which has looked at these relationships as an assembler and its suppliers went through the various phases of its supply chain restructuring.

Notes
1. These are the four phases in Berry et al.’s (2000) supply chain maturity model (SCMM), as will be explained later.
2. The findings presented here are part from a larger research – see (Varoutsa, 2011).
3. Parker and Northcott (2016, pp. 1116-7) refer to the trustworthiness of the research.
4. The exact figures are withheld to disguise the identity of the company.
5. The number in brackets refers to the interview number in Table A1.
6. As the continuity of production is of paramount importance for AIR, and the process of approving a new supplier for a highly critical commodity can take up to 18 months, AIR “pre-approves” alternative suppliers for critical commodities in order to avoid delays in delivery to final customers due to unexpected problems such as fire, natural disaster or even the bankruptcy of a supplier.
7. Operational contracts were also signed for projects AIR allocated to the JVs.
8. As mentioned earlier, there is a contract review before every new operational contract is signed. These reviews took place even during the autonomous firm phase, and they have continued to be undertaken in each of the subsequent phases.
10. As our research only involved interviews in AIR, we were unable to confirm this. But it seems to us that AIR’s assertions are reasonable.
11. In the next (serial dependence) phase of the SCMM, there was a supplementary relationship between trust and control, and we observed the emergence of goodwill trust, but not the implementation of new control mechanisms. This may have been due to the way we chronologically present our findings in terms of the four phases of the SCMM. If, instead, we had studied the changes as a continuum this supplementary relationship between trust and control might not have emerged.

12. However, we did have some informal discussions in one of the joint ventures based in the UK.

References


(The Appendix follows overleaf.)
## Table AI.
Table of interviewees

<table>
<thead>
<tr>
<th>No.</th>
<th>Date</th>
<th>Management level</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>September 2006</td>
<td>Financial director (preliminary meeting)</td>
</tr>
<tr>
<td>2</td>
<td>March 2007</td>
<td>Financial director (second interview)</td>
</tr>
<tr>
<td>3</td>
<td>March 2007</td>
<td>Purchasing manager I (first interview)</td>
</tr>
<tr>
<td>4</td>
<td>March 2007</td>
<td>Purchasing manager II</td>
</tr>
<tr>
<td>5</td>
<td>June 2007</td>
<td>Operations purchasing executive (first interview)</td>
</tr>
<tr>
<td>6</td>
<td>June 2007</td>
<td>Financial controller (first interview)</td>
</tr>
<tr>
<td>7</td>
<td>June 2007</td>
<td>Business finance partner for subsidiaries and JVs (first interview)</td>
</tr>
<tr>
<td>8</td>
<td>September 2007</td>
<td>JV relationship manager (first interview)</td>
</tr>
<tr>
<td>9</td>
<td>November 2007</td>
<td>Operations manager I (first interview)</td>
</tr>
<tr>
<td>10</td>
<td>November 2007</td>
<td>Operations manager II</td>
</tr>
<tr>
<td>11</td>
<td>November 2007</td>
<td>Management accountant (first interview)</td>
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<tr>
<td>12</td>
<td>March 2008</td>
<td>Operations purchasing executive (second interview)</td>
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<tr>
<td>13</td>
<td>March 2008</td>
<td>Financial director of operations</td>
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<tr>
<td>14</td>
<td>April 2008</td>
<td>Purchasing manager I (second interview)</td>
</tr>
<tr>
<td>15</td>
<td>April 2008</td>
<td>Financial controller (second interview)</td>
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<tr>
<td>16</td>
<td>May 2008</td>
<td>Business finance partner for subsidiaries and JVs (second interview)</td>
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<tr>
<td>17</td>
<td>May 2008</td>
<td>Operations manager I (second interview)</td>
</tr>
<tr>
<td>18</td>
<td>June 2008</td>
<td>Management accountant (second interview)</td>
</tr>
<tr>
<td>19</td>
<td>June 2008</td>
<td>JV relationship manager (second interview)</td>
</tr>
<tr>
<td>20</td>
<td>March 2009</td>
<td>Purchasing manager I (third interview)</td>
</tr>
</tbody>
</table>

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Stigma management and justifications of the self in denazification accounts

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Abstract

**Purpose** – The purpose of this paper is to study how two accounting professors at a German university dealt with their denazification, a process carried out by the Allied Forces following the Second World War to free German society from Nazi ideology. It is argued that the professors carried a stigma due to their affiliation with a university that had been aligned with the Nazi state apparatus.

**Design/methodology/approach** – The paper uses Goffman’s work on “Stigma” (1963/1986) and “Frame Analysis” (1974/1986) to explore how the professors aimed to dismiss any link with the Nazi regime. Primary sources from the university archives were accessed with a particular focus on the professors’ post-war justification accounts.

**Findings** – The paper shows how the professors created a particular frame, which they supported by downplaying frame breaks, primarily their Nazi party memberships. Instead, they were preoccupied with what Goffman (1974/1986) terms “the vulnerability of experience,” exploiting that their past behavior requires context and is thus open to interpretation. The professors themselves provide this guidance to readers, which is a strategy that we call “authoring” of past information.

**Originality/value** – The paper shows how “counter accounts” can be constructed by assigning roles and powers to characters therein and by providing context and interpreting behavior on behalf of the readers. It is suggested that this “authoring” of past information is successful only on the surface. A closer examination unveils ambiguity, making this strategy risky and fragile.

**Keywords** Frame analysis, Accounting professors, Denazification, Justification accounts, Stigma management, Third Reich

**Paper type** Research paper

1. Introduction

The roles and behaviors of individuals involved in or associated with financial scandals feature as an important topic in the accounting literature. Historical studies have shown how accountants and financial professionals engaged in “villainous” activities when the first professional bodies were formed (Walker, 1996; Chandler et al., 2008). Contemporary studies have begun to explore how individuals, in retrospect, construct information leading up to a scandal, make sense of their involvement, or justify their behavior. Gendron and Spira (2010) have shed light on the impact of Arthur Andersen’s breakdown on the identity narratives of the firm’s former employees and their efforts to incorporate events into a continuing self-narrative[1]. Similarly, Gendron et al. (2016) have examined the stories of whistleblowers, focusing on how metaphors are used to support perceptions of fairness in financial markets. In contrast to studying the aftermath of scandals, Stolowy et al. (2014) have explored how Bernard Madoff’s company constructed itself as a trustworthy

The authors thank Hans Goschel and the staff of the University of Leipzig archives for granting them access to the archival materials. They gratefully acknowledge the comments and suggestions received from Lisa Evans, Warwick Punnell, Stephen F. Walker and during presentations at various seminars and conferences. The authors also thank Lee Parker (Editor) and two reviewers for their comments and support in the review process.
investment opportunity before the operation was revealed as a Ponzi scheme. It is not only the making sense of events that these studies examine, but more fundamentally the question of what the underlying social reality is and how it is treated or constructed. Facts can be positioned as something else and the meaning of texts and documents can be shifted at the discretion of the authors. While the literature has touched on these issues, it is not yet fully explored how individuals’ explanations of events possibly create a different social reality.

This issue becomes even more important when considering documents that are intended to relieve the author from being held accountable. Such texts are prevalent in the corporate world, and the accounting literature has shown them to be carefully crafted to manage their impact on the reader (Merkel-Davies and Brennan, 2011; Evans and Pierpoint, 2015), with the originating organization taking into account the readership of reports and what this audience expects to hear or read (Skaerbaek, 2005; Christensen and Skaerbaek, 2007). It has also been shown that individuals engage in retrospective sense-making by providing justifications for actions and events (Merkel-Davies et al., 2011). The need to actively deal with personal accountability issues may be particularly pervasive if an individual carries – or is perceived to carry – a stigma, which is an attribute or characteristic that discredits the individual (Goffman, 1963/1986). The emergence and management of stigmas have been studied in accounting contexts (Walker, 2008; Solomon et al., 2013), often with a particular focus on the audit profession (Jeacle, 2008).

We contribute to this debate by analyzing personal justifications written to challenge the hegemonic view that the authoring individual is stigmatized. We examine the historical setting of the Entnazifizierung (denazification) taking place in Germany after the Second World War. It was a period when every German individual was suspected to carry the “Nazi stigma” and when, between April 1945 and mid-1946, Germans under the jurisdiction of the Allied Military Government had to formally disclose any relation to and involvement with Adolf Hitler’s regime and to be judged as to their role during the Nazi era. This assessment formed the basis for determining the consequences imposed on the individual citizen, and it resulted in people being removed from office or prosecuted and sentenced to camps, prison or, in the case of war criminals, death. Hence, people had strong incentives to provide “evidence” that detached them as far as possible from the Nazi regime and the stigma of that period. Relying on Goffman’s work on “Stigma” (1963/1986) and “Frame Analysis” (1974/1986), we study the cases of two eminent German accounting academics at the Handelshochschule Leipzig, the first free-standing business school in the German-speaking area: Hermann Großmann, who was a Professor für Betriebswirtschaftslehre und Steuerkunde (professor of business economics and taxation), and Wilhelm Hasenack, who was a Professor für Betriebswirtschaftslehre insbesondere Bankbetriebslehre und Leiter des Steuer-Instituts (professor of business economics and banking, and director of the tax institute). Both provided personal justifications as supplements to their denazification questionnaires, in which they portrayed themselves and their lives between 1933 and 1945, arguing that the Handelshochschule Leipzig’s organizational stigma should not be transferred onto them as individuals.

We treat Großmann’s and Hasenack’s comprehensive essays as “counter accounts,” which were written to challenge an official position and which narrate an alternative interpretation of events. In an accounting context, “counter accounts” can appear in a variety of forms, styles, and substances. For example, Gallhofer et al. (2006) examine websites as “counter accounts” in their study of online reporting practices, whereas Lehman et al. (2016) employ immigrant narratives to investigate immigration policies. “Counter accounts” can be written stories or oral testimonies that are employed to make oneself heard, obtain credibility and status, or avoid negative consequences for the individual or organization, comprising a heterogeneous and diverse set of materials. In line with such an understanding of “counter accounts,” we argue that Großmann and Hasenack prepared their justifications in a context of a power imbalance and with a view to challenge
the hegemonic predisposition of being stigmatized. As the Allied Military Government had many means to expose individuals that were affiliated with the Nazi regime to severe personal consequences, the two professors carefully crafted “counter accounts” to challenge the view that they had been “Nazis” and should face the consequences of this stigma.

By examining the role of accounting professors in the Nazi era and how these people justified their actions and behavior, we contribute to the limited literature on accounting and accountants during this historical period. Funnell (1998) as well as Lippman and Wilson (2007) have studied how accounting techniques have assisted the Nazis in the Holocaust, whereas Walker (2000) has examined the organization of the Fifth International Congress on Accounting under the auspices of the Nazi regime. Apart from some coverage in the German literature on the history of Betriebswirtschaftslehre (Schneider, 2001; Mantel, 2009), little has been written on the role of accounting academics during that time. To be sure, “zealous protestations of loyalty […] were repeated by hundreds of [professional] groups all over Germany” (Jarausch, 1990, p. 3). Yet, professors have different social status and backgrounds than, for example, blue-collar workers. By education and training, they are enabled to craft justification documents with eloquence and persuasion. Professors of accounting might be particularly skillful in and have expertise with responding to calls for accountability. While this could also be true for lawyers or professors of law, it is of interest to us, as accounting academics, to explore how our predecessors experienced the Nazi ideology and politics, and how they made sense of these experiences.

In summary, we suggest that our analysis enhances our understanding of how individuals control information about themselves in a historical context that had put them in a distressing and shameful situation. In particular, we examine how stigmatized individuals employ counter-narratives as a form of self-narrative reflecting on the Nazi period. We suggest that the two accounting professors used their formal justifications to describe their behavior, actions, and mindsets in a way most suitable to be judged as “not guilty.” This crafting of the accounts is similar to an “author” writing a fictional story and assigning particular biographies to the story’s characters. The author describes the context during which particular activities occur and assigns roles, power, and control to the characters, pre-determines and interprets their actions. The two professors behaved in a similar way and assumed, for example, the ability to definitely judge the impact of their narrated actions on other characters. Given that the events described in their justifications lie in the past, the “authors” used the limited availability of evidence to their advantage and, hence, exploited the “vulnerabilities of experience,” that is, the fact that there is not one true account of past events (Goffman, 1974/1986). As such a setup might also work against the credibility of the “authors,” the two professors supported their claims by using a variety of evidence, such as witnesses or surviving documents. We show that ambiguity abides and it is ex post difficult to judge the substance of the resulting manuscripts, the biographies presented and the roles claimed. Hence, “authoring” past information is risky, fragile, and not always successful because it masquerades or obfuscates the true nature and substance of an “account.” Providing further evidence of the limits of accountability (Messner, 2009), we suggest that the “authoring” of information leaves the reader wondering how much of the social reality narrated in an account has been constructed, or, more bluntly, what and how much is true or false.

The remainder of the paper is organized as follows. The next section presents our theoretical framework on stigma management, frame analysis and the “authoring” of information. We then explain our research methods, before analyzing the emergence of the organizational stigma at the Handelshochschule Leipzig in the Nazi period and the two professors’ justification accounts. The final section of the paper concludes.

2. Stigma management and justification accounts
This paper focuses on conduct stigmas, which emerge “when individuals take intentional action that violates legal or societal norms” (Semadeni et al., 2008, p. 558). Unlike other
“deeply discrediting” attributes (Goffman, 1963/1986, p. 3), a conduct stigma can be concealed such that the individual bearing the stigma may not be discredited, but is discreditable. It is of a broad form and includes any incongruence between a group’s shared values and social norms (Goffman, 1963/1986). Such deviation only becomes a stigma through a socially constructed process that begins with a singling out of an individual, who is specifically blamed, and ends when a critical mass of group members accept the claims of incongruence (Devers et al., 2009). Conduct stigma brings with itself not simply others’ disregard, but also more tangible costs in that it can impact negatively one’s professional career (Sutton and Callahan, 1987).

A stigma may not only be carried by a discredited or discreditable individual. It may also be assumed by “sympathetic others who are ready to adopt [the individual’s] standpoint in the world and to share with him the feeling that he is human and ‘essentially’ normal in spite of appearances and in spite of his own self-doubts” (Goffman, 1963/1986, pp. 19-20). This group is treated as if also stigmatized and assumes a “courtesy stigma,” carrying “a burden that is not ‘really’ theirs” (Goffman, 1963/1986, p. 31).

The concept of courtesy stigma has inspired organizational and management studies on how a stigma is embraced by association and related issues on stigma transfer. It has been explored how group misconduct is apportioned to individual members, for example, how managers are penalized for negative organizational outcomes via scapegoating (Pozner, 2008). Identity contamination by affiliation has been discussed for two kinds of organizational stigmas. On the one hand, stigmas can result from certain events, such as bankruptcy, industrial accidents or product defects, and may lead to an organizational blemish that an employee needs to recover from. On the other hand, a core stigma results from the disapproval of an organization’s core activities and such organizations are consequently involved in boundary management processes (Hudson and Okhuysen, 2009). As shown in the identity narratives of former Arthur Andersen partners (Gendron and Spira, 2010), it is by mere affiliation with a stigmatized organization that individual employees may assume a stigma. In turn, the stigma transfer gives rise to stigma management by way of self-justification and self-presentation.

**Information control through staging and framing a justification account**
A conduct stigma raises questions of responsibility (Page, 1984) and individuals may be concerned with controlling information about it or concealing it to avoid at least some penalties of perceived responsibility (Semadeni et al., 2008). Individuals are hence concerned with managing their connection to stigmatizing events in an organizational context (Page, 1984). This connection can be created via a time link or an accountability link (Semadeni et al., 2008)[2]. The former exists if an individual was employed at a certain organization when the stigmatizing event took place and does not require direct connection or responsibility. An accountability link does not require a time link, but “exists when an individual has authority over a given situation” (Semadeni et al., 2008, p. 558).

Stigma management involves the manipulation of the link between an individual and the stigmatizing event, and is exerted differently depending on whether a person is only discreditable or has already been discredited (Semadeni et al., 2008). If information about a person’s stigma has not been disclosed, the individual may attempt to hide the information about the failing (Goffman, 1963/1986). This “passing” as normal, that is, without the stigma becoming apparent, is a result of the great rewards of being seen without blemish.

Yet, once discredited, individuals need to cope with the stigma that is now commonly known. While removing a stigma may be challenging, “influencing external reactions following a damaged reputation may be less difficult” (Gomulya and Boeker, 2014, p. 1780). Such steering of others’ reaction to a stigma can be considered as the primary motivation behind the justification accounts we analyze. The two accounting professors crafted
narratives that were to alter others’ views of them as Nazi followers. Writing these accounts gave the two individuals an opportunity to dismiss any accountability link with the regime. Goffman (1963/1986, p. 62) supports that a biography is “subject to retrospective construction” and can, hence, be altered. While an individual can have only one biography, one can have a multiplicity of selves from the perspective of social roles, sustaining different selves and, to an extent, claiming that one is no longer the person one used to be. Yet, the right to be silent about one’s past is possessed only by those who have nothing to hide. Everyone else needs to have a memory, that is, an accurate and ready account of events in one’s mind. This account or frame can be subject to “the over-communication of some facts and the under-communication of others” (Goffman, 1959/1990, p. 141). Such impression management is not to be understood as a deliberate misrepresentation of facts. Discrepancies are considered unintentional or accidental, providing the presenter with the benefit of doubt, as one tries to show oneself in the best light. In turn, the audience wants to believe the story and tolerates some deviation from the norm (Solomon et al., 2013).

In this paper, we use Goffman’s (1974/1986) frame analysis to study the two professors’ accounts. Goffman’s sociology is particularly suited for this endeavor because it analyzes the organization of human behavior in social interactions (Christensen and Skaerbaek, 2007). That is, Goffman (1974/1986, p. 21) argues for the existence of “primary frameworks […] as a system of entities, postulates and rules […] to locate, perceive, identify and label” the range of behaviors and interactions falling under this framework. Put differently, a framework represents “the tacit stocks of knowledge that actors draw upon in their everyday interaction” (Christensen and Skaerbaek, 2007, p. 105). Seeking to understand the postulates and rules of these frameworks is then the main task of researchers investigating the effect of reports or accounts on the narrators’ audience. That is, the individuals behind our narratives intended to present themselves as non-Nazis or “normal,” to remain in Goffman’s (1963/1986) terms. Hence, their frame is used to present a line of activities that contains the organizational rules and premises one would expect from a non-Nazi citizen. Such a narrative could put forward convincing elements of, for instance, staying remote from Nazi activities, while seeking closeness to events that make the narrators or protagonists appear oppressed by the regime due to their otherness. Recounting these anecdotes in a convincing way then provides context to the episodes, seen “as immediately available events which are compatible with one frame understanding and incompatible with others” (Goffman, 1974/1986, p. 44). The narrator actively seeks to relay sequences of events that support the frame as evidence, thus amplifying the frame by arguing that a particular event or anecdote is most salient to characterize the narrator. At the same time, this procedure also results in a basic dilemma: “Whatever it is that generates sureness is precisely what will be employed by those who want to mislead us” (Goffman, 1974/1986, p. 251). Hence, any evidence that would support the frame is open for manipulation and efforts might be made to fake evidence. The result would be a fabricated frame, creating “a false belief about what it is that is going on” (Goffman, 1974/1986, p. 83). Yet, frame analysis is not meant to expose where a user of a framework has been deceived, but it is “a matter of uncovering the underlying hidden constructions” that have the potential to shift meanings and representations (Skaerbaek, 2005, p. 390).

We do not preclude the possibility that evidence has been faked, but suggest that the professors aimed to present themselves favorably by way of impression management. Specifically, we argue that the professors’ justifications resemble Goffmanesque stage plays. Goffman (1959/1990) extensively builds on a dramaturgical setting to examine “the strategic conduct of performers in their efforts to perform impressively” to their audience (Skaerbaek, 2005, p. 387). The notion of stage plays looks at the ways that individuals present themselves to others, arguing that they take on particular roles and go to great lengths to play these roles, aiming to avoid any slips and embarrassments in order
to get acceptance from the audience about the way the roles are performed. In our case, we may argue that the two professors are actors presenting themselves to an audience that is interested in their attitudes, socio-economic status, and their competences. The narrators emphasize desired impressions and gloss over or exclude the lesser characteristics to assume the role of a non-Nazi citizen. As they may have secrets that could undermine their roles, the actors let the audience access some of them—“free secrets”—that do not discredit "the image one was presenting of oneself" (Goffman, 1959/1990, p. 143). In contrast, the narrators may also have "dark secrets" which they will conceal, as these are "incompatible with the image of self that the [actor] attempts to maintain before its audience" (Goffman, 1959/1990, p. 140). Taken together, the two professors are seen as actors who get to choose not only the costumes they wear, but also the setting in which they perform as well as the entire act. This careful design of the front stage makes it easier to perform a coherent play, as the professors could actually write the entire stage play and manage any secrets to be relayed to the audience, all with an eye to playing the roles of non-Nazi citizens convincingly.

"Frame breaks" and the "vulnerabilities of experience"

Being written as stage plays, the "counter accounts" thus constitute frames that were to dismiss an accountability link via association with the regime. They had to address any corroborating evidence or actions of the selves during the stigmatizing period. In turn, they also had to deal with past behavior—potentially known to the audience—that may not fully be in line with the frame offered in the accounts. We make use of Goffman’s (1974/1986) concepts of “breaking frame” and “the vulnerabilities of experience” to analyze the professors’ explanations of such behavior[3]. A frame break relates to events that conflict with the entities, postulates and rules of the primary framework offered by the narrator. To put it in Goffman’s (1974/1986, p. 347) terms:

Given that the frame applied to an activity is expected to enable us to come to terms with all events in that activity (informing and regulating many of them), it is understandable that the unmanageable might occur, an occurrence which cannot be effectively ignored and to which the frame cannot be applied, with resulting bewilderment and chagrin on the part of the participants.

In brief, a break can occur in the applicability of the frame, a break in its governance.

Applied to the accounts we study, the narrated frame of a non-Nazi breaks if, for example, the individual had been a member of the Nazi party or participated in activities of Nazi organizations. The audience would then have to consider “what the delict means and what should be done about it” (Goffman, 1974/1986, p. 346). Any knowledge or appearance of a frame break would not only challenge the entire frame, but also carry personal consequences for the narrators, potentially affecting their professional careers (Sutton and Callahan, 1987).

Frame breaks hint at the difficulty of understanding “what it is that is going on” (Goffman, 1974/1986, p. 439). Thus, the framing process contains weaknesses, termed “vulnerabilities of framed experience,” which occur when behavior or activity can take on different meanings at different times. To alleviate the potential for misinterpretation, the behavior or activity requires context, often provided by individuals that clarify their intentions and resolve any potential ambiguities. Efforts are thus exerted to uncover “facts” that help to set matters right. In our case, the potential for a misguided framing is exacerbated because there might be only little information available to clarify the situation. That is, the narrated events took place in a past where actual evidence may be difficult to obtain or is no longer available at all. We argue that, in these cases, individuals are able to “author” their manuscripts and edit what is presented. While they are constantly threatened by facts “leaking out” and undermining the context provided, individuals can use the vulnerabilities of experience to shift meanings and perhaps even create deception and illusion.
Translated to our setting, the concept implies that all activities in the stigmatizing Nazi period—perhaps with the exception of overt opposition to the Nazi regime—could come under scrutiny and were to be explained by the individual. The resulting accounts may focus on, and explain, the obvious frame breaks that occurred in the Nazi era, but more generally also describe the actions, attitudes and behaviors of the individuals. The justification documents then contain a selective presentation of evidence, which the individuals considered most salient to sustain the frame of not having been a Nazi citizen. By association, Goffman’s (1974/1986, p. 240) analysis of movies applies:

No doubt the most important device is the camera itself, which, by shifting from one point to another, obliges the audience to follow along, leading it to examine that part of the scene which the director has caused to be revelatory, that is, which provides the next bit of information needed in order to maintain the meaningfulness of the developing line of action.

Similarly, in the “counter accounts” we examine, the authors take along their readers on a journey through the Nazi period, focusing the readers’ attention on particular “facts,” events, attitudes and competences, helped by the power of stigma management techniques, linguistic devices and their eloquence, all with an eye to create a certain image of themselves and to retrospectively “author” their biography.

3. Research methods

Our inquiry began in the archives of the Handelshochschule Leipzig, which are accommodated in the central archives of the Universität Leipzig (University of Leipzig, signatures UAL HHS). In a first step, we systematically screened the archives for all surviving documents for the period from 1930, when the Handelshochschule Leipzig received full rights as a university, until its closure in 1946. Our attention was soon drawn to the surviving denazification files of Handelshochschule Leipzig’s faculty to find that Hermann Großmann and Wilhelm Hasenack supported their denazification with comprehensive justifications. These justifications are part of the personnel files of Großmann (PA5483) and Hasenack (PA5607). Resonating closely with Goffman’s work on “Stigma” (1963/1986) and “Frame Analysis” (1974/1986), they can be described as self-narratives that present a certain sequence of events to make a particular argument about the narrator (Ibarra and Barbulescu, 2010). While Großmann’s account contains a segment on his personal life and a segment on his institute’s activities, the two segments are very similar content-wise, albeit not regarding their styles. Hasenack’s account consists of only one document detailing his activities under the Nazi regime. Unless indicated otherwise, the empirical section below refers to and cites from these documents as our units of analysis. In a next step, we went back to the archives to identify salient documents mentioning Hermann Großmann or Wilhelm Hasenack. We then collected secondary sources about universities during the Nazi regime, Hermann Großmann’s and Wilhelm Hasenack’s publications, and writings about these scholars to enrich the context of our study.

Our analysis was geared at examining both the manifest and latent content of the two accounts, which the accounting literature commonly describes as a modified form of content analysis (e.g. Suddaby et al., 2007; Canning and O’Dwyer, 2013). Yet, in line with Gendron and Spira (2010) and Gendron et al. (2016), we were foremost interested in the ways in which the two professors created a particular social reality. Studying their use of language and style means that we incorporated elements of discourse analysis in our methods, also by contextualizing the two documents both historically and socially (Hardy et al., 2004). While content and discourse analysis are generally distinct methods, they have some overlap and come in many variants such that they essentially may complement each other (Hardy et al., 2004). In any case, both are suitable and have been used extensively to study accounting narratives (Beattie, 2014).
We first screened all documents for relevant context information that would pave the way for our analysis of the justifications. The two accounts were then subject to two types of analyses, which were performed by the two authors independently. Initially, based on the theoretical framework outlined above, we identified the usage of stigma management tools as derived from the literature. Text passages were assigned codes to assess how the individuals were linked to certain events as well as the stigma management techniques the individuals employed (e.g. "reference to others as witnesses" or "presenting signs of the stigma as something else"). Based on a joint discussion of the coding results, the authors went again through the materials and, using an open, albeit theory-informed, coding, attempted to uncover the strategies, discourses, linguistic tools and styles employed by the two professors. Both coders discussed and consolidated their findings to arrive at the narrative unfolding below, which focuses on the two professors' framing strategies, their treatments of frame breaks and, more generally, the vulnerability of experience.

During the Nazi regime, both Hermann Großmann and Wilhelm Hasenack served as professors at the Handelshochschule Leipzig, the oldest free-standing business school in the German-speaking area. Hermann Großmann, born 1872, was one of the first students at the Handelshochschule Leipzig[4]. After graduating in 1900, he obtained his Doctorate at Tübingen University in 1903 and returned to Leipzig in 1916 as a Full Professor of Betriebswirtschaftslehre focusing on taxation. He served as Dean from 1928 to 1931, and for two further periods in the 1930s as Vice-Dean. In 1920, Großmann established a tax institute at the Handelshochschule Leipzig, where he devoted his research and teaching efforts to tax accounting, becoming an "important scholar" who "stimulated" accounting theory and practice (Hasenack, 1952). In 1938/1939, Großmann became an Emeritus, but continued to teach until the end of the war. After 1945, he focused on his audit and accounting advisory firm, while the final years of his life were characterized by "considerable hardship," before he passed away following serious illness in 1952 (Hasenack, 1952). Großmann had been a member of the NSDAP (Nationalsozialistische Deutsche Arbeiterpartei, Nazi Party) from 1933 onwards and of several Nazi organizations for professional groups (e.g. the Dozentenbund, which grouped all academic lecturers).

Wilhelm Hasenack, born 1901, obtained his Business Degree at the University of Cologne in 1923 and his Doctorate in 1925. He followed his Doctoral Supervisor to Berlin, where he completed his Habilitation in 1929. Via a short engagement in Freiburg, Hasenack came to the Handelshochschule Leipzig in 1937 as a Full Professor of Betriebswirtschaftslehre focusing on banking and taxation. From 1939 to 1941, he served the faculty as its dean. Following the war, Hasenack was dismissed for political reasons, as he had been a Member of the Sturmbteilung (SA, storm troopers), the NSDAP, and other Nazi organizations for professional groups. Unable to obtain a professorial position, Hasenack continued on short-term teaching appointments, before being re-appointed in 1949 as a Full Professor of Betriebswirtschaftslehre at the University of Göttingen, where he remained until his retirement in 1969. Starting a business research journal in 1949, Hasenack became one of the most influential post-war accounting professors in Germany.

Our narrative contains text passages from documents originally written in German, which, for reasons of brevity, are not reproduced in the original form. We are aware that the translation process complicates our study by introducing both linguistic and cultural challenges (Xian, 2008). Translation adds an additional interpretive layer to the original documents, which could potentially change the meaning of the excerpts or, by itself, construct a social reality different from the one expressed in the denazification accounts. We took several measures to address these issues. First, the entire empirical analysis was based on the original German texts. The fact that the two authors are German native speakers mitigated the bias of data interpretation (Xian, 2008). Second, the excerpts reproduced in this paper were translated into the English language only when drafting this paper.
The translation was done by one of the authors, with the second author reviewing the translated excerpts. In cases of disagreement, the authors discussed alternative English translations and occasionally added the German original, in particular where translation appeared problematic. This procedure may not fully eliminate a translation effect and we acknowledge that meaning can never be reproduced or transferred objectively from one language to another. Yet, the process introduced reflexivity to our translation and made us confident that the excerpts convey the meaning of the original texts, allowing a demonstration of the framing devices detected in the two counter accounts.

4. The emergence of Handelshochschule Leipzig's organizational core stigma

Founded in 1898, the Handelshochschule Leipzig was the first business school in the German-speaking area, aimed at increasing merchants' knowledge in the areas of languages, economics and law (Schneider, 2001). In their early days, the Handelshochschulen were seen as universities in the lower tiers (Mantel, 2009), also because they lacked academic independence, which, in Leipzig's case, implied close organizational and academic association with the local (state) university (Großmann, 1950). While these colleges of commerce also did not have the Promotionsrecht (right to award doctorates), they played a major role in the evolution of Betriebswirtschaftslehre as an academic discipline and accounting was at the forefront of this movement.

The Handelshochschule Leipzig gained administrative independence in 1911 when it became a legal entity under public law, but gained a Rektoratsverfassung, that is, academic independence, only in 1923. According to these bylaws, the Rektor (Dean) was elected from among the regular professors for two years and was to conduct the everyday business of the school. Following a constitutional reform in 1931, the Senat (Senate) consisted of all professors and took the major decisions regarding teaching and research, while the Kuratorium, made up of people from business, politics, and public administration, carried out the tasks of a supervisory board. It was only on May 13, 1930 that the Handelshochschule Leipzig received the Promotionsrecht as the penultimate business school in Germany and became a fully recognized academic institution.

Soon after Adolf Hitler was appointed Chancellor of the German Reich on January 30, 1933, he took a number of measures to suspend democratic principles and centralize power by implementing the Führer (leader) principle throughout public life. Being solely in charge of all decisions, the Führer of an organization had authority toward his subordinates and was strictly accountable to his superiors. Implementing the Führer principle throughout all organizations and institutions gave the regime total control and introduced a strict hierarchical order, while coordinating the entire society in line with the regime's ideology.

Like any university, the Handelshochschule Leipzig was also subject to this process, which became known as Gleichschaltung. On April 7, 1933, the Gesetz zur Wiederherstellung des Berufsbewüstums (law for the re-establishment of the public office) was issued and Beamte (tenured civil servants), such as professors, could be fired to simplify administration and re-establish a national public office. Reasons for dismissal or early retirement were ineptitude, non-Aryan ancestry and political unreliability. Hence, in 1933 the Handelshochschule Leipzig acted to “free” its faculty from non-Aryans by not renewing the teaching assignments of two Jewish faculty members.

In an attempt to harmonize university regulations, the City Council of Leipzig exchanged correspondence with the Saxon Government to draft a new constitution for the Handelshochschule Leipzig[5]. This draft constitution specified that the school's purpose was to serve the German nation by education, teaching and research in economics, which the Kuratorium amended by requiring an “education according to National Socialist ideology.” The constitution, which was approved in June 1934, gave comprehensive
authority to the dean, who was no longer elected by the faculty but appointed by the
government and who, in turn, appointed his deputy and all the school's committees.
In accordance with the regime's objective, power was centralized by concentrating it in the
dean. He now had broad powers over all academic and curricular decisions, with the
Senat taking only an advisory role. The constitution was superseded in 1935 by the
Richtlinien zur Vereinheitlichung der Hochschulverwaltung (ministry directives for
the harmonization of university administration), which replaced university constitutions
and made university deans Führer of the school, being solely accountable to the
Reichsminister für Wissenschaft und Bildung (Reich's Minister of Science and Education).

In his report to the Reichsministerium, Dean Wörner stated on February 15, 1935:
“Right from the first day of my term, no adjustment was needed to entirely integrate the
Handelshochschule Leipzig ideologically and organizationally into the Reich of Adolf Hitler.”
Providing examples for the smooth transformation and demonstrating loyalty to Hitler's
regime, he referred to the instruction at the entrance of the school stating
“The German salute has been implemented here. We say Heil Hitler!,” and to the institution having ordered
a portrait of Hitler in January 1934, unveiled in a formal ceremony.

In late 1936, Alexander Snyckers took over as dean and chose the Führer's birthday on
April 20, 1937 for his inaugural ceremony. Snyckers unveiled a bust of Adolf Hitler at the
school giving a short speech, which was sent to Hitler himself, honoring the Führer “in his
dearest worship, thanks, and full of faithful wishes for you and your work. In the honor
room of Handelshochschule Leipzig, your bust will from now on urge teachers and students
alike to deploy everything for Nazi Germany and its Führer, for the idea and the man, in
which we believe.”

Under Snyckers' deanship, new doctorate regulations were approved in June 1938,
restricting access to the doctoral examination. Foreigners needed approval from the
Reichserziehungsmiister (Reich's Minister of Education) and Jewish applicants were
banned from obtaining a doctorate. Furthermore, doctoral candidates needed to prove theirs,
and their wife's, Aryan heritage. Besides, the revocation of doctorates was reformed.
Not only did academic or severe social misconduct induce the process of revocation.
Anyone considered unworthy of a German academic title could lose their doctorate.
Although Dean Synckers considered these changes “essentially only formalities,” the
revised regulations further implanted the Nazi doctrine in the organization.

During the war years under Deans Wilhelm Hasenack and Arnold Liebisch, existential
issues took over at the Handelshochschule Leipzig. With the outbreak of the war in
September 1939, the school was closed for several months. When re-opening in January 1940,
the academic year was restructured by ministerial order from semesters to trimesters, giving
the faculty a higher teaching load. Half of the male faculty and staff, among them all but one
assistant, were in army service and doing research became practically impossible, also
because of severe shortages of paper and coal. In a December 1943 air raid, most of
Handelshochschule Leipzig's facilities were destroyed or severely damaged forcing the school
to further limit its services.

In April 1945, the US Army seized Leipzig and Liebisch resigned from office. On May 1, 1945,
the remainder of the Kuratorium elected Friedrich Lütge as new dean. The appointment of
Lütge, who had not been a member of the Nazi party, showed that the school aimed to take a
fresh start. He oversaw the end of the war, the taking over of military administration by the
Soviets, the dismissal of most of his colleagues and the Senat decision to integrate the school into
the University of Leipzig, which was completed in February 1946. Lütge's short deanship was
also the period when the Handelshochschule Leipzig's entire faculty underwent the process of
denazification, showing that their employment relationship had transferred what was now
considered an organizational core stigma onto the individual, who was presumed to carry the
Nazi stigma.
5. Stigma management in the denazification process

The justification accounts: “frame analysis” and “stage plays”

Based on Goffman’s proposition that people may construct their biographies retrospectively, Großmann’s and Hasenack’s justification accounts were framed to accommodate their treatises on why they did not carry the Nazi stigma. In the following, we analyze their accounts in terms of how they built a frame in these documents when outlining their behaviors and activities between 1933 and 1945.

In spite of his status as an Emeritus and presumably with a view to restore his and his institute’s reputation, Großmann compiled a post-war account of his activities during the Nazi regime. In fact, this account came in two parts with one being written on his “anti-fascist attitude […] in his private sphere,” dated August 19, 1945 and supplemented on October 15, 1945, and the other as an “evidential portrayal about the partly neutral, partly opposing attitude of the research institute for economy and taxation vis-à-vis the party,” dated August 26, 1945[6]. They coincided with two decrees of the Soviet military administration that had to be translated into law by the regional authorities (Krone, 2001). On August 17, 1945, a directive of the state of Saxony ordered the re-organization of public administrations by way of dismissing all former Nazi party members, unless they had special expertise and had not been actively serving the party or the former regime. When it appeared that this directive was only reluctantly applied, another Soviet decree was issued in October 1945, tightening the earlier one by requiring dismissal of Nazi party members by mid-November.

While Großmann’s “counter account” does not refer to these events, it transpires from the archives that he was afraid of losing his professional credentials. Yet, his account was written as a general statement to fend off any impression of having been a Nazi. The institutional segment contains a section on the purpose of the account, suggesting that it was foremost Großmann’s Nazi party membership that put a stigma on the tax institute and its leaders such that “every former member of the party is obliged to provide evidence on his political attitude.” This evidence was to be used to classify Nazi party members into categories of guilt that were proposed at the Potsdam Conference, namely whether they were war criminals, party officials, active members, or followers (Namensträger). Without being accused of untoward behavior, Großmann provided lengthy justifications, for which he was free to choose a particular style and mode of presentation.

The account’s two documents most notably differ in terms of their perspectives: The personal segment is written as a first-person narrative and, in that way, receives a particular emphasis and personal note, making the document more compelling to the reader. Großmann includes personal descriptions of his family, interactions with Jewish friends and takes a strong position against any militaristic attitude. Portraying himself as a pacifist and humanitarian, he describes how he shunned any party activity, making himself not an apolitical person per se, but an apolitical individual during the Nazi era. This document is supported by strong personal endorsements from individuals, who were persecuted by the Nazi regime. Their statements go beyond mere testimonials, describing how Großmann supported these disadvantaged people actively during the period that stigmatized him.

The institutional segment is based on Großmann’s personal justification, as it contains large sections from the latter, incompletely modified into a third-person narrative[7]. The institute and its directors are positioned as neither political nor taking part in resisting the regime, which, to some extent, contradicts the account’s headline. Hence, some of the convincing elements from the personal account are absent in the narrative and the evidence presented fails to engross the readership. Moreover, the institutional piece is set up as an “expert opinion” featuring a legal style with more than 120 individually numbered paragraphs. Most importantly, the author retreats from the narrative, presumably to increase its objectivity and to arrive at a clear-cut conclusion, partly concealing the fact that the author
effectively acts as his own judge. Yet, the third-person narrative lacks personal endorsements and is muted by a certain distance and passivity of the narrating self. This disconnectedness hinders an effective management of the stigma and a manipulation of the accountability link, which restricts the use of stigma management tools to a reproduction of “facts.”

On a fundamental level, Großmann’s documents establish a boundary between the narrating self and stigma activities. That is, Großmann uses rhetorical devices to separate two groups of individuals, drawing a clear boundary between them and creating a contrast between their activities (Gieryn, 1983)[8]. He defines what is “good” (stigma-free) and “bad” (stigmatized) in a binary way, demarcated by whether something or someone was affiliated with the Nazi party. This demarcation is enhanced by labeling others in a particular, stigmatizing, way. One person is described as a “typical ‘Nazi newcomer’” (typischer ‘Nazi-Emporkömmling’) and others are made “Nazi fat cats” (Nazibonzen) or “racial fanatic” (rassefanatisch). That contrasts to an episode where one of his own employees had been called a “servant of the Jews” (Judenknecht). This labeling fosters the binary nature between the stigmatized and stigma-free and goes in hand with the (self-)classification of former Nazi party members’ guilt that the account aims to get at. The boundary between Großmann and the institute on the one hand and the Nazi regime on the other is also erected on a symbolic level, when he discusses his unwillingness to use the insignia of the Nazi audit group on the institute’s letterheads. A similar symbolic character is given to his leaving it up to his secretaries whether to close letters with the “German salute” (Heil Hitler!). This episode describes a supposedly antagonistic act, making the salutation a symbol that is more than just the closing of a letter, namely a further element of the inscribed boundary Großmann created.

The account then portrays the institute and its directors as a non-party and apolitical network, ring-fencing their activities by describing them as necessarily stigma-free. This presentation is facilitated by anchoring the institute and its directors to individuals, events and symbols that stood in opposition to the Nazi party. For example, the institutional segment describes ties with Non-Aryans, who spoke at institute events, were audit and consulting clients, or were supported during Großmann’s deanship. After the war, Non-Aryans and everyone who was persecuted by the Nazi regime were naturally regarded as being stigma-free. Actively seeking and exploiting his association with these individuals in the stigma period, Großmann aimed to embrace their clean biographies to be perceived as “normal” himself.

At the same time, the author perceives his accounting expertise as making him apolitical, implicitly alluding to the opening in the Soviet decrees that could potentially shield him from stigmatization. Großmann’s field of expertise is described as “solely of a corporate nature and [it] does not give any reason for political statements,” while he is “a corporate and legally educated man of the highest objectivity,” who “never saw any reason to address political issues” in his publications[9]. Such a description understands objectivity as absolute and coinciding with expertise. As agents of economic expertise, Großmann and his institute stand far removed from the Nazi party and, more generally, politics. The institutional document takes this framing almost to the extreme:

26. The general theories of economy and currency have been repurposed many times according to the National-Socialist view, but have remained unchanged in their content and nature. This is because the economy has innate autonomous laws. These assert themselves continuously in spite of changing political systems. Hitlers come and go. The laws of the economy and culture remain.

34. Prof. Großmann has not been politically active at any period of his life. He only lives for his academic work and his university. He is similar in this respect to that mathematician of the ancient world, who during the capture of the city of Syracuse called to a soldier that destroyed his circles drawn in the sand:

“Do not destroy my circles!” (emphases in the original).
Yet, the objectivity of expertise is relaxed when it helps Großmann to detach himself from the stigma. Having acted as an expert on individuals who were repressed by the Nazi party is used as a means to set the boundary between the stigma-free institute and stigmatized others. Taking positions against the Nazi party or its members does not compromise “objectivity,” but it seems that his frame suddenly necessitates a certain partiality:

68. Hence, it is proven by the above described opinions that Gr. did not shy at taking position against the party. Had he been a fanatic “Nazi”, he would have sacrificed his objectivity for the party.

Had he been a convinced member, he would have declined the opinions so as not to conflict with his objectivity.

Had he been an uncritical member, he would have let himself be influenced by the “infallibility of the party” and would have written the opinions under the spell of the party.

Prof. Großmann gave the opinions for individuals hard-pressed and persecuted by the party, hence his attitude was party-opposing (emphases in the original).

Similarly, Großmann asserts that he was faithful to “the old principle of neutrality, that is, to hire non-[Nazi party] members,” and that “performance was always in the foreground […] which was why no Nazis were hired in the offices of the institute or could sneak into them.” The detailed numerical accounts of his employees show that seven of his employees were politically persecuted, one of which had been in a concentration camp. Notably, two of the institute’s post-war employees had been Nazi party members, one of which he describes as a “non-member in behavior” and the other was discovered to be a member only after being hired. The quantification of the employees extends the presentation of the institute as a non-party network. By signaling to the reader an absoluteness of both truth and fact, it reinforces the binary worldview expressed in the account. Yet, by making competence and qualification criteria for his stigma-free network and cornerstones to its boundary, Großmann detaches expertise from the Nazi party, thereby not only contradicting his own claim of objectivity, but also shifting the meaning of “expertise” from an assessment of one’s capability to being related to one’s political attitude.

In contrast to Großmann’s functional account stands Hasenack’s self-justification, which is dated December 20, 1946. It was written at a time when he struggled to re-gain a foothold in post-war Germany. Given his Nazi party affiliations, he had been dismissed from the school on November 15, 1945, presumably in response to the Soviet decrees, only to be re-employed in April 1946 by way of an emergency service contract (Notdienstvertrag). On August 20, 1946, he was redeemed politically by the Soviet administration, but failed to be re-appointed as a professor in spite of the support from the remaining faculty members, in particular the then-Dean.

Hasenack states that his “counter account” responded to student claims that he had been a “Nazi professor.” The accusations, which we did not find in the archives, seemed unspecific in that they did not refer to particular episodes when the accused supposedly acted in the interest of the regime. Hasenack takes up this issue in his opening paragraph, saying that he did not know what the criticism was about or how he needed to defend himself, but that he felt obliged to “justify himself particularly broadly” and to “preventively” comment on any potentially stigmatizing situation (emphasis in the original). The type of the accusation hence characterizes the ensuing account, with broad and unspecific claims requiring sweeping justification statements.

What runs through Hasenack’s account is a criticism of the students who now accuse him of having been a Nazi, while appealing to the readers’ understanding of his
motivations and providing an appropriate description of his activities during the Nazi regime. His account is infused with irony and sarcasm, emphasizing his protest at being stigmatized:

Isn’t it a weird “Nazi professor”, who is afraid that another world war would lead to “an unspeakable downfall of the European nations”, who finds strong words against “science in marching boots” and “with a sledgehammer”, and who takes position against “infantile neologism” and rants from the [Hitler Youth] against science, [and] who warns against a “rude tone of pigs” etc.

This interaction with the reader is bracketed by summary statements on Hasenack’s political attitude, where he outlines his position during the Nazi regime. He concludes the account on behalf of the reader, stating that he did what he could to reasonably work against the party within the limits imposed by the regime. Given this Goffmanesque bracketing and interaction, Hasenack’s account is best characterized as the write-up of a stage play displaying an instructive and moralizing nature, which reminds the reader of the Antique theatre. This impression is visually enhanced by partly hand-written editorial mark-ups throughout the manuscript, shifting of sentences, emphases by way of underlining phrases, indents, insertions and deletions. As will be argued in the following, the type of “evidence” put forward, setting of context, and interpretation complete this characterization as a Goffmanesque stage play.

The body of the account is set up on the basis of vignettes, short episodes from 1933 to 1945 that are to serve as evidence for Hasenack acting against the Nazi regime or, at least, not in the interest of the state, and are intended to manipulate the stigmatizing accountability link. The vignettes are accentuated by six lengthy appendices, containing numerous statements supposedly demonstrating his opposition against the regime. Yet, a closer examination yields a range of statements and excerpts, which may leave a reader unconvinced, because they refer to destroyed manuscripts, or may ex post not show the criticism of the regime that Hasenack claims to have uttered. The following two excerpts exemplify how such criticism may not become obvious in short and isolated statements:

It is always of essential importance for the value and reputation of a science that its ambassadors are independent and impartial.

[…] the danger of an overly strong personal striving for power of individual people or authorities.

We need to think about how we can avoid these dangers.

These statements emphasize Goffman’s (1974/1986) point that context is important for a frame and that past events are particularly vulnerable. The lack of interpretation, context and description shows that “evidence” needs to be framed to have a meaning. That is, the statements make clear the ambiguity of framed experience. Context is needed to make episodes meaningful, but at the same time it makes experience vulnerable because the context might be “authored.”

Providing further evidence of framing his account as a stage play, Hasenack interweaves a description of episodes with his interpretation, thus situating it within the wider events. For example, he refers to his pamphlet against Hitler’s construction policy, which, as he claims, was picked up by an “anti-fascist academic abroad” and, consequently, drew attention from the propaganda ministry, thus endangering him of persecution. When realizing he had to be more cautious in his criticism, he would combine an anti-Nazi statement with some pro-Nazi rhetoric. In Goffman’s (1974/1986) terms, such a strategy would carefully manufacture the experience of the audience, upholding a particular frame that is repeatedly broken by criticism. Hasenack explains this strategy as follows:

In my publications, I have offered factual criticism in numerous instances. […] This criticism was as open and strong as it was possible at a time when freedom of thought was suppressed. The expert to whom the statements were usually addressed knew what I meant in spite of the sometimes necessary “clothing” [of the statements]. Frequently, certain developments or government measures occurred around the publication dates that provided to the knowing reader a strong criticism in my phrasing behind a superficially perhaps innocuous and respectable statement (similar to a “stage” for the “second brain”).
Hence, Hasenack describes how he constructed a particular frame in the past. As this framing in the past may not be obvious to the present reader of his justification account, he now deconstructs and explains the past frame in detail. Claiming that this was the only option to express any criticism of the Nazi state, Hasenack offers the strategy as a wide-ranging motivation for his activities during the period. His account frequently describes how he used his speeches as Dean or official publications as a stage to appeal to a “second ear,” similar to Goffman’s (1974/1986) concept of “keying,” which involves cues to the audience to signal a transformed or altered meaning of the information conveyed.

This interpretation is fostered by a description of his classes. He claims to have used the classroom as another “stage” to work in the interest of students, express criticism against the regime and educate his audience toward free-thinking individuals. Clothed in the garments of expertise and an analysis of accounting matters, Hasenack argued that he did not limit himself to a discussion of concepts, but included political statements in his classes. This approach stands in stark contrast to Großmann who consistently claims to have acted along the ultimate principles of objectivity and neutrality, focusing only on professionalism and expertise.

In summary, we showed how Großmann produced a functional account of himself, portraying his actions and those of his institute as purely driven by expertise and objectivity. Such a frame suggests a ring-fencing of his network, outside of which stood the Nazi regime. Hasenack offers a stage play-type of account, which frequently involves the reader. He weaves other stage plays into this account, namely the ones he performed during the Nazi era to subtly vocalize criticism against the regime. While both individuals provide an unspecific, general justification of their past behaviors, Großmann puts much emphasis on his frame of boundary management, whereas Hasenack focuses on the various stage plays. By presenting the past information in congruence with the account’s purpose, both individuals construct social reality in the form of a particular frame, which is upheld linguistically and by twisting words or arguments that follow the logic and intent of the “author.”

"Authoring past information; “frame breaks” and the “vulnerability of experience”"
Assessing the content of Großmann’s and Hasenack’s justification accounts, we argue that they recount anecdotes to exploit the vulnerability of experience, while downplaying frame breaks. What results is a careful “authoring” of their biographies that, by interpreting contexts, behaviors and roles, goes beyond mere descriptions of activities.

Through his account’s frame, Großmann created a strict boundary around his network that separated it from the Nazi regime. Only when talking about his own role does the author relax this boundary, which causes the frame to break. Großmann calls himself an “obligatory party member,” describing his joining of the party as follows:

17. After Prof. Wörner was elected as dean in February 1933, he approached Prof. Großmann as his oldest full professor with the following statement: “We do not have any party members among the professors. I am the founder of the Stahlhelmorden in Leipzig[10]. So, I will find closed doors everywhere. Some professors need to become members in the interest of the university”.

18. Subsequently, Gr. joined the party on 1/5/33. Other professors followed. At that time, every German could agree with a good conscience to the aspirations of the party.

Positioned in the opening sections of the account, this description portrays Großmann’s party membership as an incidental matter, resulting from professional pressure to act in the interest of the university. Put differently, it was his professional self that joined the party, whereas his personal self remained apolitical. The frame break is further qualified by the party being described in a benevolent way. Hence, the party membership is treated as a “free secret,” which can be disclosed to the audience without much harm to the frame. Yet, Großmann does not mention that his joining on May 1, 1933 was actually the last possibility
to become a party member. Access to the party became restricted after the March 1933 election had cemented Hitler's power, because the swaths of new joiners were not seen as convinced Nazis, but as opportunists joining the NSDAP for their personal benefit[11]. Großmann frames his party membership as a professional act of good faith, although the historical context and the date he became a member convey ambiguity.

Following up on the framing of the institute and its directors as non-political agents, the account re-addresses the (self-)classification of guilt. By discussing what would have happened, had the author not managed his network boundary, Großmann reflects on alternative strategies available during the Nazi period. The author presents scenarios on the consequences of open resistance, which ultimately would have led the self into a concentration camp, potentially dramatizing the implications of hypothesized actions. At this point, the author gives up on the boundary erected earlier in the documents. Now, the question of "guilt" is what defines the stigma, and no longer the relation to the Nazi regime. The author eventually becomes his own judge on the question of whether he is "worthy of a political acquittal." Signing a sworn declaration, the author concludes:

1. Following the classification of party members by the Potsdam Conference into the 4 known groups, it is proven beyond any doubt through the professional work of Prof. Dr. Großmann, Dr. Gerth and Dr. Neubeck that they were only "bearers of the name or insignia" of the party, that is, useless members, so [they were] not party, but only so-called index members[12] [...].

2. It was more useful for the general public that they work silently, but continuously against the party, instead of openly, that is, tactically imprudent, just to be bereaved after a short while of all party-opposing work [to be sent to] the concentration camp [...].

3. They thus belong, following the declaration of Smuts [a South African politician], not to the guilty ones, but to the non-guilty ones, because Smuts declared:

"The question is not:

party member or non-member,

but

guilty or not guilty" (emphases in the original).

This closing statement reveals the intent of its author. Having demarcated party and non-party members in a binary way, the documents now show that Großmann was pre-occupied with justifying his party membership, which resonates with the concomitant decrees from the Soviet administration. Yet, his "counter accounts" erect norms only for those outside the ring-fenced network, and party membership is the sole criterion to stigmatize others. For Großmann, activities within the network make him stigma-free and his party membership is not relevant for assessing whether he is stigmatized or not. As activities are subject to the vulnerability of experience, they are well suited to "author" past information. In that sense, they help to justify obvious frame breaks, which are claimed to be negligible. Ultimately, this view allows the narrating self to deflect the stigma, beyond and independent of any boundary established for others.

In turn, Hasenack seems aware of the difficulty of presenting frame breaks favorably. Hence, he treats his affiliations with the party as a "dark secret" and either ignores or downplays them. Archival sources suggest that he had been forced to join the storm troopers after being photographed at a gathering without showing the Hitler salute or singing along. While it seems that his formal affiliation with Nazi organizations, that is, the frame break, could have been "justified," Hasenack did not address it in his account. A theoretical conjecture suggests that this frame break might have undermined his framing of experiences. Hasenack’s entire claim to have staged his life between 1933 and 1945 might then suggest that looming negative consequences were always the justifying reasons for his
pro-regime actions. His comments on Hitler's construction policy serve as an example. Arguing that he attracted attention from the propaganda ministry, Hasenack considered this attention a precursor of potentially being followed by the Gestapo (secret police). Hence, he changed course and, as he claims, published a newspaper article on 'the German acadeine and their role in the National-Socialist state' to shield himself of accusations that he opposed the Nazi regime. This vignette provides the context for the excerpts reproduced in his account's appendix. They also describe the strategy that Hasenack claims to have followed throughout the time, namely one of "protective alignment" (Schutzanpassung). The assertion that such behavior was strategic and needed for one's own safety could ultimately justify any frame break of the narrating self.

His account gives a major role to his publication of a brochure on the Handelshochschule Leipzig during war-time (Hasenack, 1941). Hasenack describes a colleague's warning that students had reported him to the secret police. As a consequence, he resigned as dean and published the brochure as an "effective justification" instrument, giving the following vignette a headline that already connotes a certain impression to the reader. The brochure itself contained an overview of the university's activities, and its faculty's and students' contributions to the school's constitutional objectives. Hasenack explains how he sent a copy to all students, his colleagues, and a number of Nazi party authorities. He claims that the first two groups knew how he really thought, so he was not particularly concerned about the perception he created there, but that he was addressing the Nazi party officials who had doubted his loyalty. In spite of creating a supposedly pro-Nazi artefact, the publication was said to contain numerous critical phrases, as Hasenack details in the appendix of his justification account. He claims that the brochure also enclosed edited versions of some of his speeches, where colleagues had approached him about his editing of the manuscripts ("But you didn't say that!"). The brochure may be seen as the prime example of Hasenack's "authoring" of his past behavior, aiming to demonstrate how he had been able to create a certain impression on the part of the brochure's readers. This episode also gives him the opportunity to expand his account by way of flashbacks to clashes with party officials, for example, reporting on one official's avowal that "Hasenack should be given a good beating" (Hasenack müsste man die Hosen stramm ziehen). The entire episode helps the "author" in his claims that the "special purpose brochure" had an impact on one group of people (Nazi officials), but not on others (in particular his students). Using direct speech as evidence of others' reactions makes Hasenack's opposition more vivid and supports his claim of having been in an adversarial position. In that sense, the quotation marks serve as Goffmanesque keys that are to signal to the reader that facts or evidence is reported. Yet, the direct speech may or may not have been taken place as noted by Hasenack. That is, the quotes may have been "authored" by using quotation marks as keys, such that the evidence provided through the direct speech is only linguistically enhanced, but in fact remains on the same authoritative level as any other evidence provided. Hence, Hasenack perceives himself in a position to define proper cause-and-effect relations, supporting the image of a "stage" that he created for his criticism and which he employs again in his denazification account. It also demonstrates how Hasenack interprets the context of the vignette for the reader and assigns particular roles and powers to himself and others.

Like Großmann, Hasenack uses the Nazi party to create distance between himself, his students and "others," frequently using witness testimonials for support. The boundary between the "many" non-Nazi students and the "few" politically active ones is furthered, when Hasenack reports additional instances inside and outside the classroom. These vignettes range from anecdotes with party officials labeled as "others" to describe how Hasenack experienced negative outcomes due to his political positions to interactions with persecuted individuals he supported during the Nazi era or to which he related in one way or another (e.g. references to Jews and Half-Jews).
A further section on “a crucial individual case and its consequences” discusses how the regime planned to simplify accounting requirements, so that people working in corporate accounting departments could join the war. Describing how he fundamentally criticized this plan by way of underlining the importance of accounting, Hasenack uses expertise and objectivity as arguments to support his case. He reflects on his criticism as strong words against a “hara-kiri project,” a label that is offered ex post to emphasize the message he had sent in the past. He also claims that a Nazi follower would not have expressed himself in such a way, thus assuming knowledge of others’ behavior, thoughts and actions, just as an “author” does.

Summing up his account, Hasenack describes three choices any non-Nazi academic had under the regime, framing these options as the only ones available, and interpreting them in a seemingly unambiguous linguistic fashion:

a) The academic remained “neutral”, [and] failed fundamentally in my view […].

b) The academic was active and was openly anti-fascist. In this case, he would, with absolute certainty, be deprived, through incarceration, of the opportunity for further anti-fascist activity […].

c) The academic remained faithful to the core of the scientific idea, […] but adapted on the outside (e.g. as a party member) to cover up.

Claiming that the last option would, on the surface, be considered opportunistic, Hasenack said it fundamentally contained the wish to oppose the regime and to educate students. He states that this description referred to what he did, namely to always act in a “factually sharp battle in partly open, partly disguised, but always dangerous ways.” In that sense, he offers a synthesis of his analysis that appears as a factual presentation, but is framed to support the way he acted. Given this guidance toward approving his behavior, the reader is urged to conclude that the last option is best. Hasenack thus “authors” his activities and motivations to support the impression of an active critic of the regime that had to disguise his true intentions, while offering some final interpretations of his actions (sharp battle), his position (dangerous) and his ultimate goal (opposition).

In summary, we suggest that the two professors – using their own styles and based on their individual preferences – possibly shift interpretations in their favor by way of “authoring” past information. Großmann is preoccupied with justifying his party membership and aims to shift the meaning of this frame break by assigning it to his professional self. His personal self was sincere, and he demonstrates that his descriptions of behavioral details, various activities and events are aimed at constructing the social reality of a “non-member in behavior,” as he says about one of his employees. Aimed at the verdict of “not guilty,” the account disregards the fact that tolerating something, such as a regime, may be closely related to enforcing it. Großmann seems foremost eager to exploit the framing techniques to renounce his association with the regime.

Hasenack, by contrast, takes a more active role in his justification, in that he alleges not to have been a passive dissident, but a critic of the regime, being as active and open as possible. Claiming that his criticism had to be voiced carefully to avoid personal consequences, his justification closely resembles the dramaturgical metaphor of Goffman (1959/1990). Not only is his “counter account” written in the form of a stage play that includes a prologue, different vignettes (which one could label “acts”), and an epilogue. Hasenack also claims that he played the role of a Nazi follower to the outside, appealing to the “second ear” to express criticism of the regime. Thus, he was opposing the Nazis not only back stage, but also when performing as a dean on the stage, albeit more carefully. This framing of experience is indicative of Hasenack’s ability to play with words and arguments, using his eloquence to shift meaning, construct a particular frame and, hence, exploit the vulnerabilities of experience.
6. Discussion and conclusion

Employing the denazification accounts of two eminent German accounting professors, this study connects to previous work on how accounting individuals retrospectively deal with scandals. While Gendron and Spira (2010) and Gendron et al. (2016) have shown the impact of such scandals on identities and identity narratives, we have explored how individuals justify their roles and involvement in such events, and how they ex post aim to portray themselves positively by way of impression management. Likewise, this study contributes to the limited literature on accounting and accountants during the Third Reich. It has been shown that accounting techniques have been employed in the service of the Holocaust (Funnell, 1998; Lippman and Wilson, 2007) and that accountants have been exposed to the totalitarian Nazi regime (Walker, 2000). The present study provides additional insights into the retrospective sense-making of and justifying potentially “villainous” activities (Walker, 1996) in a context where accounting individuals responded to calls for accountability relating to their behavior during the Nazi reign.

In the immediate aftermath of the Second World War, Hermann Großmann and Wilhelm Hasenack crafted comprehensive self-justifications reflecting on and explaining their activities and behavior during the Nazi regime. These justifications were intended to dismiss any accountability link with the regime, thus presenting the professors as non-Nazi citizens under the regime. Both individuals were motivated to justify themselves by fear of personal consequences, primarily career restrictions and social stigmatization. Yet, their situations were fundamentally different. Großmann was a Professor Emeritus and managing an audit and accounting advisory firm. Still in the process of building his academic career, Hasenack stated he was motivated to deliver a justification by the fact that he wished to secure a proper business education for future generations of students.

The nuanced differences in their motivations in part explain the differences we observed in the stigma management techniques and approaches. Großmann’s “counter account” contained two parts. One is written as a first person narrative containing personal experiences and stories, thus emphasizing agency and engaging with the reader. The other, institutional part is written in a formal style, one could describe as legalistic, containing barely any personal notes. Großmann focused primarily on the framing of his account, suggesting that there was a boundary between himself, his firm and the Nazi party. He presented a type of professional expert opinion on himself, portraying his actions and behavior as taking place in a ring-fenced network of non-ideological, apolitical and strictly objective experts, which was isolated from the Nazi regime, although interacting with the “outside” world occasionally. He concluded that he and his network did not carry any stigma, because the network was defined by its activities only, and not by formal signs of the stigma, such as Nazi party membership. These signs constituted frame breaks, and Großmann argued they had been imposed on him and his associates. Hence, he used the supposedly stigma-free network to define, shape and manage information in the stigmatizing Nazi period and beyond by way of managing the boundary between the narrator and any potentially stigmatizing activities.

Hasenack’s justification reads differently. He presented the story of his life, that is, his biography, with the help of numerous episodes supposed to demonstrate his resistance to the Nazi regime, which he enriched with self-citations from that period. His past actions and behavior were “authored” as a Goffmanesque performance with a view to unveil this staging in his justification account. Hasenack’s case demonstrates one of the difficulties associated with this type of staged behavior. It may not be clearly identified or verified as such, because the evidence required to support the identification of such behavior might be weak or no longer existent. One can see Hasenack struggling with that, as he focused on the “authoring” of his biography. He composed a justification that is rich in narrative
descriptions, mentioning many witnesses and other case evidence, while having to admit that they are or might not be available anymore.

As it has been shown that people carrying the same stigma use different discursive patterns to make sense of their experiences (Gendron and Spira, 2010), we demonstrate that justifications of the self also tend to have an individual flavor. The differences may not only be driven by discrepancies in the individual’s motivation, but also by their attempts to control information in the stigmatizing period. In that sense, we identify two types of information control. One intends to manage impressions now, with a view to potentially using this information later. An example would be Hasenack’s appeal to the “second ear,” where he introduced ambiguities in his speeches and publications, to be used as justification devices at a later point in time. The other type of information control refers from the present to the past and denotes a choice of information that is suited to present a certain image of the author. The resulting narratives necessarily fall prey to assertions of “cherry-picking” information. At the same time, the documents depend on narrative strategies that open the door for interpretation based on the interplay between text, author and reader (Collins et al., 2015).

Underlying both types of information control is then a notion of opportunism. Reading justifications, the audience constantly wonders how critical they are or should be of the authors and how much of the “story” has resulted from opportunism. While this behavioral aspect is even acknowledged by Hasenack in the conclusion of his account, it can be taken a step further. Ultimately, one might claim that Hasenack’s well-crafted account only results from his skill of making the reader believe in a certain image, regardless of his actual behavior. While, in all likelihood, actual events and behavior were somewhere in the middle, the extreme example shows the dilemma of finding the “truth” in “counter accounts,” rendering both the self and the account opaque (Messner, 2009).

What Goffman (1974/1986) terms the manufacturing of experience gives us further insights into the authors’ use of information control. Most strikingly, both professors, but Hasenack in particular, were preoccupied with justifying their behavior, actions and attitudes. Frame breaks, by contrast, appear of lesser importance. We attribute this finding to the breaks being “facts” or artefacts that can be verified more readily. For the purpose of upholding a particular frame, these breaks are dangerous, as they cannot be manipulated. While Großmann struggles with this issue and ultimately uses his entire account to explain his Nazi party membership, Hasenack ignores his formal Nazi affiliations entirely. It is thus not surprising that the authors claim that their behavior deserves more attention than frame breaks. Experience can be subject to a shifting or framing that is needed for information control and is therefore better suited for selecting episodes that might be interpreted favorably by the authors, and for the creation of a certain image. Given the lack of context, said to be of utmost importance for a frame (Goffman, 1974/1986), experience can be manufactured and its vulnerability used for one’s advantage. This manufacturing is what we call “authoring” of past information and it goes beyond a mere use of evidence in that it includes assumptions on how particular actions have affected others, or assumes knowledge of others’ thoughts, judgments and behavior. Both accounts we studied make use of others, be it as witnesses or to assign blame. Goffman (1963/1986) suggests that the co-opting of selected individuals can work as a protective circle for the stigmatized. We also show that the concept of “others” is used to justify one’s behavior. That is, “others” pressured the self into doing something, as in the case of Großmann’s party membership. “Others” were the ones who were aligned with the regime and against which the authors demarcate themselves by creating a boundary. “Others” were assigned blame based on their party memberships, whereas the selves were innocent.

Beyond being vulnerable to a shifting of meaning, experience suffers from incomplete availability of information (Goffman, 1974/1986). As the self presents the “evidence” that
is available, the resulting frame is affected in two ways. Missing pieces of information can be used to the “author’s” advantage, further shifting the meaning of experience and supporting the image to be created. By contrast, with an increasing vagueness, lack of “evidence” works against the “author,” moderating the claims that are made to the point where the self’s credibility is questioned. Given the temporal setting of our case at a time when large parts of Germany were destroyed, it is difficult to assess to which extent “evidence” could be presented or would ideally be required. Yet, we conjecture that a certain amount of supporting “facts” is valuable to give credence to the story being told.

Leaping to the present, we can relate our study of historical “counter accounts” to the corporate environment, arguing that managers also find themselves constantly in need to justify actions, behavior and decisions while using narratives or other accounts to discharge their accountability (e.g. Merkl-Davies and Brennan, 2011). It seems reasonable to assume that managers are aware of justification devices, and therefore try to craft “counter accounts” carefully. Yet, we do not know whether and how managers employ an “authoring” strategy when presenting justifications or accounts more generally. Future research might build on the literature surrounding the involvement of (accounting) individuals in scandals (Gendron and Spira, 2010; Stolowy et al., 2014; Gendron et al., 2016) to further enhance our understanding of the retrospective sense-making involved in “authoring” these individuals’ narratives. Cases such as justifications following the detection of fraud, narratives on justifying performance, or reactions to environmental damages seem worthy avenues to pursue, adding to the existing literature on the storytelling of and in organizations (Boje, 1991, 2008). Similarly, future research could explore the ways in which the audience perceives and makes sense of the information provided and to which extent it requires additional context or relies on the justifying self’s interpretative guidance when assessing what might be “true” or “false”.

Notes
1. There are subtle differences between narratives, stories and (non-numerical) accounts. Whereas (self-)narratives contain sequences of events with the purpose of arguing a point (about the narrator), stories additionally contain a more or less structured plot (Boje, 1991; Ibarra and Barbulescu, 2010). Accounts may have features of both, but typically respond to a perceived call for justification or accountability. We use these terms interchangeably.
2. Location is a third possible link, but is not needed for conduct stigmas (Semadeni et al., 2008).
3. “Breaking frame” (Chapter 10) and “the vulnerabilities of experience” (Chapter 12) are separate and distinct elements of Goffman’s (1974/1986) frame analysis. Our choice of these, rather than other concepts, was not predicated on a link between them, but their suitability for our analysis of the two accounts.
4. Unless noted otherwise, biographical information is taken from the archival materials and Mantel (2009).
5. In Germany, the federal states traditionally enjoy sovereignty and legislative authority over a number of executive areas, one of which is education. The Handelshochschule Leipzig was hence administered by the state government of Saxony. At the same time, the city of Leipzig partially funded the school, such that members of the City Council also sat in its Kuratorium.
6. Both segments contain Großmann’s publication list and an overview of his output as an appendix in a resume-like format. It is not clear whether the appendices are intended as part of the justification or whether they are purely informational in nature.
7. This segment also seems to be written by Großmann himself, although it was signed by three directors of the institute, with the fourth director being absent.
8. We are aware of the literature stream on “boundaries” and “boundary work” that started with Gieryn (1983) and extended into the accounting literature (e.g. Suddaby et al., 2007). We are not overly concerned with a thorough analysis of “boundary work” in this paper, but borrow the terms as descriptors of Großmann’s frame.

9. Großmann also refers to statements from Eugen Schmalenbach attesting to his objectivity, further exploiting the role of others in the framing of his activities.

10. The Stahlhelm was an organization of First World War veterans founded in 1918, meant to conserve the comradeship among former front-line soldiers. Yet, with more than one million members in the early 1930s, it was seen as a paramilitary organization rivaling Hitler’s storm troopers (Sturmabteilung). When Adolf Hitler rose to power, the Stahlhelm began to harbor persecuted members of the moderate political parties, thereby increasing tensions with the Nazis and eventually leading to the Stahlhelm’s usurpation by the storm troopers and its dissolution in 1935 (see the testimony of the Stahlhelm’s Chief Treasurer Theodor Gruß at the Nuremberg Trials, August 13, 1946, afternoon session).

11. Only at a later stage does Großmann mention that he did not wear the party insignia initially to avoid being made fun of as an opportunist.

12. Individuals who were members in name only.

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Descriptor | Signatures
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Senat, Ausschuß des Senats | 98-144
Professorenrat | 150-152
Rektorat | 158-165
Institute | 168-173
Lehrkörper, Beamte, Angestellte, Assistenten | 257-277
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Sonstiges | 630-639

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A dispute in the making
A critical examination of displacement, climate change and the Pacific Islands

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Abstract

Purpose – The purpose of this paper is to present a forward-looking case of climate change induced displacement in the Pacific Islands as a multidimensional phenomenon with a moral dimension. Instead of seeking to provide a definitive solution to an imagined problem, the authors have identified the complexity of the situation through an exploration of the accounts of place and accountability for the consequences of displacement.

Design/methodology/approach – The paper explores displacement from a sociological perspective. The authors use the sociology of worth (SOW) to anchor explicit and competing moral claims in an evaluation regime that considers questions of justice and the common good. The public accounts of place in the Pacific Islands provide the empirical material for a consideration of a situated crisis. While SOW is generally adopted for current crises or disputes, this study explores the pre-immigrant story and a future case of displacement. Bauman’s (1998, 2012) perspective on globalization is used to narrate the local conditions of place in a global context as reflective of a dominant social order.

Findings – Since place is a multidimensional concept and experienced according to various states of being including physical, functional, spiritual and emotion or feeling, displacement is also felt at a multidimensional level. Thus to provide an account of a lived experience and to foster a moral accountability for climate induced displacement requires a consideration of multiple accounts and compromises that need to be considered.

Research limitations/implications – As with the majority of accounting research that is concerned with the suffering of those at a distance, we too must tackle this conundrum in a meaningful way. As members of a society that is the largest per capita emitter of greenhouse gas, how do we speak for our drowning neighbors? The paper concludes with some insights from Boltanski (1999) as a way forward.

Originality/value – The paper presents a forward-looking scenario of a looming crisis from a sociological perspective. It adds to the literature on alternative accounts by using stories, media, government reports and other sources to holistically build a narrative grounded in a current and imaged social order.

Keywords Accountability, Pacific Islands, Sociology of worth, Environmental migration, Climate change induced displacement

Paper type Research paper

1. Preface

Billy Goats Gruff; three goats displaced from their food; cannot get over the bridge
Cinderella; displaced into an undesired life of chores, mockery and abuse
Nemo; a clown fish; displaced from his home and family in the Great Barrier Reef
Shrek; a cranky ogre; displaced from his swamp
Simba; The Lion King; displaced from the Pride Lands
The Three Little Pigs; forcefully displaced from their houses
Woody; Toy Story; displaced from his home with Andy
And, Dorothy; the Wizard of Oz; displaced from her world
Childhood stories have long been used as a way of making sense of an uncertain future. These narratives serve as a means of organizing experiences, developing knowledge and communicating culture and beliefs that reflect the physical, social and spiritual worlds (Murphy, 1996). And together with the metaphors they evoke, allow popular imagery to assist in interpreting complex and uncertain phenomena (Czarniawska, 2004, 2012).

The stories and folk tales above are examples of different types of narratives of displacement. The characters experience disruption of place whether from their house, geographical location, family, ability to access food or a human existence. Yet, the beauty of fiction is that it presents an explicit moral goal, and we use it because we recognize a truth in the possibility of a happy ending or an intelligible narrative (understanding) of our lives. In particular, The Wizard of Oz touches on global understandings of anxiety, conflict and aspiration, the complexity of experience and disputed situations. This story is used in this paper to highlight the growing dispute over the responsibility and the need for action to prevent the Pacific Islands from inundation from climate induced sea level rise. These islands are on the Yellow Brick Road, and all the promises of development and social change from industrialization may turn out to be as disappointing as the Wizard was for Dorothy.

2. Start at the beginning

Places are laboratories of diversity and complexity, mixing social functions and natural processes. […] A place cannot be understood from the vantage point of a single discipline or specialization. It can be understood only on its terms as a complex mosaic of phenomena and problems […] The study of place, by contrast, enables us to widen the focus to examine the interrelationships between disciplines and to lengthen our perception of time (Orr, 1992, p. 129).

We live in a world with an abundance of wealth and natural resources and advances in technology, albeit unequally distributed. In this world many of us find security and sanctuary in our sense of place, while other communities face the threat of “dis”placement from the effects of climate change. Nowhere is this threat more salient and compelling than in the story of climate induced sea level rise and the uncertain future for an “environmental migrant” from the Pacific Islands. As recently as December 2015, 195 nations together negotiated The Paris Agreement with the aim of reducing this threat[1]. The Agreement established a global plan to: minimize climate change (below two degrees Celsius) by reducing greenhouse gas (GHG) emissions through ambitious targets to avoid destabilizing the Earth’s climate system; and improve accountability for climate change impacts and increase support for adaptation (United Nations Framework Convention on Climate Change, 2015). Notwithstanding, certain Pacific Islands currently endure the real threat of drowning as a result of continued climate changing activities of industry and agriculture. Therefore, to make sense of what is happening and to understand the challenges, a broader set of accounts of “place” for Pacific Islanders is presented from a sociological perspective.

This paper introduces a story of accountability for climate change induced displacement. We adopt Schweiker’s (1993) understanding of accountability as a multidimensional concept with a moral dimension, as it gives a sense of what it means to give an account and a theory of rendering action intelligible. To consider the moral dimension of place and a more nuanced sense of accountability, we found the sociology of worth (SOW) developed by Boltanski and Thévenot (1991/2006) from French pragmatic sociology, to be a useful heuristic for a discussion of the competing rationales of place and the dimensions of an account in a situated dispute, albeit from a western interpretation of environmental migration. SOW provides a framework to analyze a “situation” with the objective of a compromised outcome or conclusion. In doing so, SOW considers the generalized moral claims that underpin seven social arrangements or orders of worth or worlds and the justification of these claims (Annisette and Trivedi, 2013).
According to Boltanski and Thévenot (1991/2006) justification occurs in the public domain, therefore SOW is appropriate where disputes are public. Indeed, controversies that arise from the different evaluations of a situation and the modes of justification for actions are only visible in disputed contexts (Wagner, 1999). In this case, we identify the different concepts of place offered by SOW’s seven justification regimes (orders of worth) and, in doing so, identify the various dimensions of giving an account or forms of evaluating displacement. Previously, Annisette and Trivedi (2013) adopted SOW to explore the compromised identities and boundaries of place in a professional context, and this paper adds a further dimension of place from the perspective of future displacement. While critical accounting research has questioned the impacts of climate change and also the challenges of migration (see e.g. Annisette, 2003; Hammond et al. 2009; Lehman, 2012; Agyemang and Lehman, 2013; Lehman et al., 2016; Perkiss and Tweedie, 2017), the Pacific Island issue and environmental migrants as a forward-looking case of displacement is new. In effect, all we can tell is the pre-(im)migrant story of a future dilemma or disaster arising from a current disputed situation. In conceptualizing displacement, we explore the notion of place as a multi-layered construct that evokes polyvocal accounts of a desirable order of things (Boltanski and Chiapello, 1999/2007).

“Displacement,” therefore, is understood by considering the disruptions to “place” according to its physical, functional, and psychological aspects (Klatenborn, 1997; Knez, 2005; Lewicka, 2010). This paper taps into this notion in a meaningful way with a question that drives a story of marginalization – how do we account for and justify the impacts on place from climate change induced sea level rise on the Pacific Islands? While it is a simple question, the response is complicated, complex, multiple, and nuanced.

We contribute to the accounting literature in several ways. First, we articulate an essential conversation of displacement in the Pacific Islands due to sea level rise and the compromises that need to be considered. As Czarniawska (2012, p. 771) comments:

In times when the societal role of humanities and social sciences is put under a rather hostile scrutiny, wouldn’t it be advisable to listen to such marginal stories with their atypical plots? Accounting research has one foot in each of the camps, and perhaps because of that it could offer an intermediate forum, where two-way translations could take place.

As Wagner (1999, p. 348) asserts, SOW is an “empirical sociology of contemporary society” and each situation or context will exhibit different compromises and modes of accounting to achieve a just outcome. For example, in France justice is linked with equality reinforced in civic arrangements, whereas in the USA it is a component of a legal system (Wagner, 1999).

Second, we extend the accounting literature by considering multiple and alternative accounts explicitly linked and specifically anchored in a particular situational context. Alternatives to the mainstream economic account are gaining traction in the accounting literature as representative of a more enabling accountability (Lehman et al., 2016). Gray (2002) provided accounting scholars with the motivation to imagine new forms of accounting and accountability; while Walker (2016) challenged scholars to develop new understandings and ongoing investments in conceptual thinking. Many scholars have responded including: the contribution by Brown et al. (2015) to consider creative thinking and engagements in meaningful intelligible accounts that reveal alternative values; Atkins et al.’s (2015) proposal of a utopian sustainable world through idealic imagination; Thomson et al.’s (2015) problematization of governance structures and traditional accounts in order to foster social and environmental accounting research; and Killian and O’Regan’s (2016) use of social accounting narratives as symbolic power to uncover the reflexive processes of multiple accountabilities. SOW presents an evaluative compromise for disputes (Wagner, 1999), rather than an arena (combative) or utopian (ideal) or a general theory of justice to further an enabling form of accountability in the form of multiple accounts.
Third, we develop a framework that can be applied to accounting in other global issues of disaster or displacement by anchoring the local conditions of place in Bauman (1998) and Boltanski and Chiapello’s (1999/2007) reflections on capitalism as a new order of power relations or regime of justice that subsumes the traditional domestic order. Bauman (1998) considers the inter-relatedness of contemporary society in a globalized world to provide a story of displacement that draws on mobilization and marginalization in a political and social context. Several ideas characterize the relationship between globalization and place, including: the division of society into either tourists or vagabonds (Bauman, 1998); the loss of territorial roots and cultural distinctiveness (Gupta and Ferguson, 1997); and, the reduction of individual freedom (Schweiker, 1987). Finally, as a fourth contribution, we discuss the limitations of speaking for the distant other and propose a way of resolving this tension.

The paper uses the metaphor of the Wizard of Oz to drive the story of displacement. We begin with “It’s a twister, it’s a twister!” which presents the Pacific Island situation and pending environmental migration phenomenon. “There’s no place like home” explores the concept of place and the complex and multidimensional aspects of displacement. “Follow the yellow brick road” introduces SOW as a framework for analysis; and, “It’s no use screaming at a time like this. Nobody will hear you. Help! Help!” explores the issue of displacement in the Pacific Islands. The paper illustrates in “Close your eyes and tap your heels” that, while the various justifications of place and evaluation of what is means to be displaced are competing, a compromised outcome may provide an opportunity for those displaced. With this, the paper concludes by imagining a future world in “Close your eyes and tap your heels together.”

3. “It’s a twister, it’s a twister!”
Climate change induced sea level rise is the cause of the slow-onset process of Pacific Island displacement and future environmental migration, and “is one of the major long-term consequences of human-induced climate change” (IPCC, 2010, p.vii). It is predicted to cause more floods, storm surges, ecosystem change, greater erosion and increased water salinization (Church et al., 2010), which will have a diverse impact on nations, communities, infrastructure, settlement and services (IPCC, 2007). Although sea level rise is global, the distribution of the current and future rate of sea level rise is not spatially uniform over the global oceans (Church et al., 2010; CSIRO, 2011). Citizens of South, South East and East Asia (Stern, 2007) and the Pacific Islands are most at threat of sea level change as they are considered the most vulnerable to each degree of increase in temperature (IPCC, 2001); have the highest annual distribution of sea level rise in the world[4] (CSIRO, 2011); and are already considered disenfranchised. Therefore, this study focuses on the “vanishing” Pacific Islands, consisting the Islands in Micronesia, Polynesia and Melanesia in the Pacific Ocean.

The Pacific Islands most vulnerable to sea level rise include[5]: the Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Papua New Guinea, Republic of Marshall Islands, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu (Pacific Islands Forum Secretariat, 2013; World Bank, 2015). As an example of vulnerability, in Tuvalu, 100 percent of the population live below five meters above sea level, Marshall Islands, 99.4 percent and Kiribati 95.2 percent (World Bank, 2011a). The inherent paradox is that while the Pacific Islands states are most impacted by climate change, they contribute only 1.1 metric tons per capita of CO2 emissions, compared to the 9.9 metric tons per capita of the OECD members (World Bank, 2011b).

In 2009, over 350 million people were considered displaced for a multitude of reasons, including weather conditions and changes, poor health and living standards, poverty, hunger, disease, and social and political instability (Annan, 2009). Of these, over 25 million
were considered “climate displaced people,” individuals quietly (outside of media headlines) displaced due to gradual environmental change, such as desertification and sea level rise (Annan, 2009). Displacement due to sea level rise is an emergent yet substantial threat that is a result of climate change that will result in group categorized as “environmental migrants” (El-Hinnawi, 1985; Gibb and Ford, 2012; Kniveton et al., 2008; Morton et al., 2008) or “climate migrants,” “environmental refugees” (Friends of the Earth Australia, 2010; Myers, 1995, 2002, 2005; Timberlake and Tinker, 1984), “climate refugees” or “climate change refugees” (Brown, 2011; Stratford et al., 2013), “environmentally displaced persons” (IOM and RPG, 1992; UNHCR et al., 1996), “climate displaced persons” (Annan, 2009; McAdam, 2011) or “ecomigrants” (Castles, 2002; Wood, 2001). While a plethora of labels exist, the common theme is a group of people experiencing movement, migration, and displacement because of economic, political, demographic, social, and environmental phenomenon and human processes (Black et al., 2011a).

The term migrant (or immigrant depending on the locus of interpretation) is itself a multifaceted phenomenon giving rise to complex policy and social issues (Lehman et al., 2016). When considered in the context of climate change, the definition of communities living under these conditions has very little (political or social) consensus. Myers (1993) presents the following definition that resonates with the concept of place and displacement:

People who can no longer gain a secure livelihood in their erstwhile homelands because of drought, soil erosion, desertification, and other environmental problems. In their desperation, they feel they have no alternative but to seek sanctuary elsewhere (p. 752).

Myers (1997) predicted that environmental migration will rank as one of the largest global human crises of our times. While the IPCC (2013) recognizes there is a lot of guesswork in predicting the number of future environmental migrants, it, along with Myers (2002, 2005)[6], Stern (2007) and the Foresight (2011) report suggest between 150 million to one billion environmental migrants worldwide by 2050, especially as global warming takes hold. Further, the Environmental Justice Foundation predicts that 10 percent of the global population is at risk of forced displacement due to climate change, that is, by 2050, one in every 45 people in the world will experience displacement mainly from living in floodplain areas (Vidal, 2009).

4. “There’s no place like home”

[We need to] relearn respect for the land we inhabit and to renew our ties both sacred and less exalted as a countermeasure to the thoughtless destruction of modern life […] [we need to know] a kind of history that includes, but reaches far beyond, what we can learn from the archaeologies and histories one finds in museums today […] [we share a quest for personal knowledge, for self-conscious information about being-in-place, and for participation that can catch us in the act of complacency about who we are, where we have been, and where we are going and thereby might change our thinking about the meaning of life in the landscapes of our respective pasts and presence. What they seek is, in that sense, more poetic than scientific (Brady, 2000, p. 981).

Place is a discursive construct; home, a house, residence and human dwelling, geographical location, home-world, an individual state. Place is represented by the inhabited Earth, its ecosystems, and the ways in which humans dwell (Schweiker, 1987). Having a sense of place is vital to identity and what it means to be human, e.g. the question, “where do you come from?” encompasses notions of origin, status, culture and ethnicity, and is dependent on the notion of ecology, freedom, community and justice (Mackay, 2010). Place is a journey of memories, interests, hopes and values, and a purpose for being in the world (Schweiker, 1987). Therefore, the desire for place is unambiguously owned by each individual in which their comfort and pleasure is sought.
Place is also constructed by non-static conditions including the characteristics of society – culture and tradition, relationships, family, suffering, objects (Mackay, 2010). Society is never neutral, and is shaped through behaviors, culture, politics, and economics (Touraine, 2003). Therefore, the construction of place is dependent on social interaction and everyday practices (Hammond, 2004). Although each individual is a product of the one world, the world is experienced differently through social engagement, politics, and power (Turton, 2005). As Annisette and Trivedi (2013, p. 6) so succinctly argue:

Boltanski and Thévenot observed that legitimate arguments in a dispute were never idiosyncratic. Instead protagonists would divest themselves of their personal circumstances and ground their opinions in a broad set of commonly held values, generally seen as just.

Therefore, as Thévenot et al. (2000, p. 236) also maintain, justifications and critique “make some claim to general applicability by reference to different sorts of values, principles, or models for judging what is good, worthy, and right.” And as a result, morality is considered as a set of repertoires of justification (Annisette and Trivedi, 2013). Since SOW is concerned with social arrangements and the moral justifications for a certain desired state of being, the various accounts of worthiness provide evidence of multiple accountabilities.

Schweiker’s (1993) approach to accountability gives a sense of how accounting discourse is a means of rendering action intelligible. Schweiker’s (1993) understanding exposes accountability as a discursive act, motivated by external relationships, where interrelationships contribute to the meaning of life and the shaping of moral action. The connection between society, accounting and [global] “place” has emerged in the critical accounting literature. For example, studies on immigration and employment (Lehman, 2005) and the reduction of freedom for those individuals unable to shake off global intrusion (Lehman, 2006); and, the studies that focus explicitly on language and accounting as a means to overcome the economic focus on issues such as (im)migration, globalization, identity, and the meaning of place (Annisette, 2003; Lehman, 2006; Hammond et al., 2009; Lehman, 2012; Agyemang and Lehman, 2013).

In different contexts different compromises lead to different conclusions. Displacement, climate change, and migration are complex issues with multiple drivers and impacts (Black, 2001), especially in the case of the Pacific Islands where replacement will be impossible. Researchers, such as McGregor (1993), Tacoli (2009), Shen and Binns (2012) and Castles (2002), argue that the environmental drivers of displacement cannot be separated from other social, political, and economic drivers. According to SOW, a sense of justice emerges from distinct disputes or controversies (Wagner, 1999). Therefore, it is particularly salient to evaluate the unique situation of displacement and future resettlement or replacement.

5. Follow the Yellow Brick Road

SOW is based on a set of institutionalized logics and considers that which is worthy or the justifications and compromises to achieve a state of worthiness (Annisette and Trivedi, 2013). This state differs according to seven evaluative regimes (Huault and Rainelli-Weiss, 2011) or orders of worth that involve: compromises or compatible justifications between orders; tests to measure particular/contested attributes; evidence in the public domain for consideration; and, subjects and objects used to qualify worth. In this paper we consider the role of accounts as evidence within a SOW regime.

The orders of worth have been inspired by what appears to be a disparate collection of philosophical writings (Wagner, 1999). However, as Boltanski and Thévenot (1991/2006) articulate, the choice of tradition was a decision based on whether a particular philosophy offered a systemic expression of the common good in contemporary society. Agreement of the common good is established at a general higher level where parties are no longer able to compromise (Perkiss and Moerman, 2017). At this point of general agreement “it is possible to
assess the relative worth [...] to agree or judge themselves wronged, lodge a protest, and demand justice” (Boltanski and Thévenot, 1991/2006, p. 67). In *On Justification*, Boltanski and Thévenot outline the development of the orders from a position of concordance evident in political economy theory and market equilibrium juxtaposed with a range of orders based in political philosophy. We begin with the market worth founded in Adam Smith’s (1776) *Wealth of Nations* (and other works) which includes elements of economic liberalism, the free-market and private interest accumulation (Boltanski and Thévenot, 1991/2006). In the market world, accounts that justify are generally constructed on the traditions of financial accounting, reporting, and disclosure prepared to provide information for economic decision makers.

The following orders are considered in juxtaposition to the market world and provide a basis for equivalence and ordering principles based on aspects, such as esteem or sovereignty in the process of evaluation. Boltanski and Thévenot’s (1991/2006) industrial worth utilizes the “modern socialism” of Saint-Simon. These conditions are represented by tools and processes, such as performance evaluation measurement systems. In an accounting context, industrial worth is evidenced through improved managerial decision-making protocols, and increases in technology and productivity to enhance economic efficiency (Dillard and Layzell, 2004). While it is essentially economic, industrial order focuses on the long term as opposed to the short termism of market worth.

Rousseau’s (1672, cited in Boltanski and Thévenot, 1991/2006) image of a just society informs the civic worth as represented in relationships that sustain the principles of equality and democracy. Civic accounts reject private-interests and justify the collective or general common good (Schweiker, 1993) through the relationship between government and society (Mulgan, 2000). Hobbes’ social contract, as imagined in Leviathan (1651, cited in Boltanski and Thévenot, 1991/2006), constructs the fame worth. Media attention and public concern is used to evaluate a state of worthiness (esteem according to the opinion of others) bound by the notion of transparency (Thévenot et al., 2000) to determine the level and limits of moral accountability. To be accountable requires an audience and a story (account) as an impetus for social change (Odugbemi and Lee, 2011). In the public domain, accounts such as news broadcasts[7] and other media require a space to allow openness in the flow of information and the ability for society to engage in debate (Neu, 2006) in order to evaluate and justify the common good.

The domestic worth adapts Bossuet’s *Politics* and political philosophy which is derived from a hierarchy of trust (Boltanski and Thévenot 1991/2006). The power and worthiness of leaders is translated into regulated, lawful, and respectful sovereignty. The power and control of government also reflects domestic worth by ensuring private property rights, respect for individual or communal emancipation and wealth. While these hierarchical regimes of power are said to be subsumed by capitalism in modern western (and global) contexts (Boltanski and Chiapello, 1999/2007; Wagner, 1999), for this paper, we draw on the domestic worth and the common good that is achieved through personal and institutional bonds and hierarchies within more traditional family situations. Here, a place of “belonging” for each individual, family and community is evidenced through accounts that demonstrate ownership and maintain and justify hierarchical relationships in community.

Boltanski and Thévenot’s (1991/2006) inspired worth reflects the Christian theology of St Augustine and the doctrine of grace. It stands in direct tension with the fame worth that relies on acknowledgment and the opinion of others as it uses reflective tests to evaluate the common good. These subjectivities are present in inspired world accounts that express feelings and emotional sensitivity and the individual freedom to reflect. Agyemang and Lehman (2013) question: how does an individual envision accountability for self when the vulnerable actors who require this accounting do not have the power to do so? While subjective, testimonial accounts are not always considered as “factual” or verifiable, SOW recognizes evidence from such sources as stories, songs and poems to evaluate inspiration.
The inspired worth often evaluates the most worthy from those most deprived, in a worldly sense or according to the logic of other worlds; these are the ones that turn to grace and imagination (Boltanski and Thévenot, 1991/2006).

While not in the original orders of worth, a seventh world, the green worth was established to evaluate environmental issues. Latour (1998) found that, although nature was represented in other worlds (e.g. water, the landscape and pollution are all embedded in domestic accounts), not all relevant aspects of the political ecology were evident. Following, Thévenot et al.’s (2000) study of environmental disputes, a specific order was introduced drawing on a generalized understanding of the environment to explore how the common good can be advanced through environmental sensitivity. This is reflected in pragmatic and anthropocentric practices that aim for sustainability and environmental protection.

SOW uses a specific language in its framework for analysis. Objects, as the mechanisms or trappings of worth, and subjects, or actors, are qualified to assess a higher common principle that drives an understanding of the common good or state of worthiness or state of deficiency. As Shearer and Arrington (1993) argue, everything begins with the body or lived existence, and therefore, human dignity is a necessary requirement for individuals to achieve a state of worth. According to SOW, a moral sense is embedded in two basic requirements: identification of a common humanity and combined with order gained through a general principle of worth that governs associations in a given situation (Boltanski and Thévenot, 1991/2006). In this study, the body represents an arrangement of both objective and subjective aspects of human existence. Therefore, we identify disruptions to the body as indicators of a deficient state (displacement) in seven orders of worth. In some orders, the “body” is represented objectively, e.g. an account of health status or degree of injury is evidence in the civic world. In other orders, the body can aid justifications according to mental modes of existence, e.g. in the inspired world a deficient state is experienced through accounts of fear and anxiety. This inclusion of body is necessary as emotions, feelings, actions and justifications require, and begin in, one’s body or lived existence (as described by Shearer and Arrington, 1993).

For this analysis, we utilize concepts and expressions of place to test the state of worthiness or its deficient state – displacement. Accounts of place are considered here as evidence of a state of worthiness or deficiency. Evidence, according to SOW, comes in a form or mode of knowledge suitable to the worth. Similarly, judgment or justification and how it is expressed is also dependent on the worth under examination and the manifestation of the higher common principle (Boltanski and Thévenot, 1991/2006). The higher common principle is a general abstraction and individuals use an investment formula to assess what must be given up or sacrificed for equivalence. Justification occurs in a public space by those in dispute and observers and judges (Wagner, 1999). Since SOW is concerned with disputes in the public domain, publicly available material including: government reports, regulation and policy documents; organizational and NGO publications; media releases; and published interviews, speeches and testimonials were used in context-specific manner. These accounts are multiple, ranging from official accounts to what we consider counter/alternative accounts or marginalized stories of the vulnerable (Lehman et al., 2016; Perkiss and Moerman, 2017). For example, government reports are a suitable account to use as evidence for the civic worth, just as a song or prayer is evidence of an inspired worth.

As Schweiker (1993) suggests, to render life intelligible one must be able to account for one’s existence in a meaningful way. In addition, Boltanski and Thévenot (1991/2006) claim that human beings are moral and have an authentic desire for justice. Therefore, SOW has the potential to be a theory of moral action (Annisette and Richardson, 2011). According to Boltanski and Thevenot (1991/2006), a relation of worth specifies order among the states of worth to accommodate the common good by combining both states of worthiness and deficiency. As argued, the way in which one expresses deficiency from a position of worth or
privilege is different from those in a position to qualify. Thus, we arrive at the tension of speaking for a distant other (Boltanski, 1999), and we address this point further in the Discussion section of the paper.

Although SOW provides us with a localized displacement story, Bauman’s understanding of the consequences of modernity anchors this situation into the global narrative of climate change. Bauman identifies this narrative as occurring in an era of liquid modernity, that is characterized by fear, consumerism, separation of power, uncertainty, consequences, identity construction, and outcasts (Bauman, 1998, 2000, 2002, 2003, 2004b, 2006, 2007, 2012; Perkiss and Handley, 2017); diminishing geographical, political, and cultural boundaries (Bauman, 1998, 2004a, 2011); and reduced moral and ethical boundaries (Bauman, 1993, 2008; Bauman and Donskis, 2013). Similarly, Boltanski and Chiapello (1999/2007) discuss neocapitalism in terms of the destruction of natural resources and the pursuit of profits as a globalizing ideology present in local conditions. These themes are considered in the final section.

The SOW framework in Table I is adapted to specific situational/contextual aspects of the Pacific Island case and highlights the conditions of worth, justifications, and evidence provided by accounts. Although the higher common principle and common good in each world is already threatened by sea level rise to some extent, the most severe impact of total inundation can only be imagined as a precautionary tale. Just as folk tales are anchored in a moral state of order, the forward-looking displacement story relies on current predictions, stories, evidence, fears, and opportunities. The imagined state is considered a form of alternative account that combines aspects of investment formulae and relations of worth to tell a story of the distance other.

6. “It’s no use screaming at a time like this. Nobody will hear you. Help! Help!”

Giving an account is subjective and guides us toward a common good and the identification of a moral responsibility or accountability (Schweiker, 1993). As indicated, this analysis uses accounts that qualify each worth and are therefore considered intelligible, which means they facilitate a moral accountability with respect to place. Schweiker (1993) provides a useful heuristic here, as he believes giving an account is a discursive act that emphasizes a moral existence by engaging in the ethical question of “how should we live?” (Schweiker, 1993, p. 232). Subsequently, Schweiker (1993) argued that society is in an era of moral turmoil and constant dispute over the just distribution of goods and services. What chance do society and individuals have to render their own and intersubjective lives intelligible in an era of destruction of a lived experience from climate change? The evidence (accounts) and the arrangement of objects and subjects (the body) are considered in the following analysis, as well as the implications of a deficient state for the Pacific Islands. It also includes a discussion of both general justifications that serve the common good and individual justifications as grounds for personal engagement (Boltanski and Chiapello, 1999/2007).

6.1 Market accountability

A general justification for the Pacific Island case is embedded in the opportunity and ability to promote, create, and sustain local markets and access to global markets that will accumulate shared prosperity. Examples include the World Bank development projects that offer a “hand up” not a “hand out” to the Pacific Islands (World Bank, 2015), the Pacific Islands Forum Fisheries Agency that assist in sustainable fishing (FFA, 2015), and country-specific development plans, such as Kiribati’s pursuit of economic growth (National Economic Planning Office, 2014). In the Pacific Islands, a state of worth is justified through a fair and efficient market; that is, being in a market and having the
<table>
<thead>
<tr>
<th>Market</th>
<th>Industrial</th>
<th>Civic</th>
<th>Fame</th>
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<th>Green</th>
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<tr>
<td>Fair and efficient market</td>
<td>Future scaffold</td>
<td>Solidarity and sovereignty</td>
<td>In the spotlight</td>
<td>Positioning in a hierarchy</td>
<td>Spiritual</td>
<td>Social ecology</td>
</tr>
<tr>
<td>Market price, GDP and institutional disclosure</td>
<td>Scientific information, Long-term planning</td>
<td>Rules and procedures, especially inter-governmental and supranational</td>
<td>News and other media e.g. NGO reports</td>
<td>Traditional ownership claims</td>
<td>Subjective and reflective e.g. poems and stories</td>
<td>Subjective and ecological</td>
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<tr>
<td>In or out of the market, e.g. international and Pacific Island markets</td>
<td>Stability and inclusion in long-term plans, e.g. adaptation</td>
<td>Self-determination and geographical (physical) presence</td>
<td>To be “in the news”. A public forum</td>
<td>Part of community, tradition and culture</td>
<td>Psychological and emotional presence.</td>
<td>Anthropocentric relationship</td>
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<tr>
<td>Inability to participate in the market</td>
<td>Ambiguity and inaction</td>
<td>External categorization and dependence</td>
<td>Being ignored or silenced</td>
<td>Migration or separation from culture and community</td>
<td>Sanctuary</td>
<td>Anthropocentric relationship</td>
</tr>
<tr>
<td>Agency</td>
<td>Strategy</td>
<td>Empowerment</td>
<td>Attention</td>
<td>Cognizance</td>
<td>Expression</td>
<td>Co-existence</td>
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**Notes:**
- An intelligible account is a formal or informal (counter) narrative that represents evidence of worth.
- Objects in complicated arrangements are presented with subjects in situations “that hold together” to objectify worth (Boltanski and Thévenot, 1991/2006, p. 142).

**Source:** Adapted from Boltanski and Thévenot (1991/2006), Anisette and Richardson (2011) and Thévenot et al. (2000).
opportunity to participate. Displacement occurs when an individual or group is “out of a market” – locally or internationally.

An evidential account in the market world includes calculative economic data, such as GDP. The Pacific Island small state members of the World Bank have a tiny combined GDP of US$8.25 billion (2014 data) (World Bank, 2014), indicating deficiency in market worth in a global context. The Pacific Islands are dependent on economic activities, including commodity exportation, tourism, fishing, and agriculture production. However, while agriculture in Kiribati accounts for 25 percent of this GDP, 22 percent in Tuvalu and 28 percent in Vanuatu, this economic activity will be severely impacted (if not lost) by the effects of climate change.

At a local level, tourism is the largest export sector and contributes to employment, sustainable development, economic growth, and national GDP (Wong et al., 2012). Climate change is set to change the nature of tourism in the Pacific, directly, through changes in temperature and extreme weather events, and indirectly, as it will change the natural environment that attracts tourists and basic services, such as food and water (Becken and Hay, 2007).

Market worthiness, therefore, is largely dependent on and compromises with the green world as the IPCC (2007) indicates:

Coral reefs, mangroves, and seagrass beds, which provide the economic foundation for many small islands, often rely on “stable” coastal environments to sustain themselves […]. Their [coastal] location alone renders them highly vulnerable to future climate change and sea-level rise. Tourism is a major revenue earner and generates significant employment in many small islands. Changes in temperature and rainfall regimes, as well as loss of beaches, could be devastating for the economies that rely on this sector (p. 846).

Finally, sustainable fishing markets are also set to decline due to climate and environmental factors, depressing stock prices, e.g. of tuna, and increasing market uncertainty (Radio New Zealand, 2015). While the predicted and visible changes significantly threaten individual lives, livelihoods and the availability to produce and access food (Annan, 2009), it further emphasizes displacement as a loss of marketability. The loss of place or market access, including tourism and agriculture, represents a deficient state of economic livelihood, which flows through to an individualized state of poverty.

6.2 Industrial accountability
A general justification for industrial worth is represented by a future scaffold that ensures long-term sustainability, through development and empowerment. Displacement occurs where there is ambiguity, inaction, or actions that challenge future stability and threaten the success of strategic planning.

At a local level, the Pacific Islands characteristically have inadequate access to resources, human capital, employment, technology, and infrastructure (Bowman, 2005; IPCC, 2007) that disrupts the sustainability of a long-term scaffold. A scientific account that incorporates long-term predictions provides assistance for planning and managing the consequences of climate change. Actions that promote measurable goals include: access to secure funds, risk management plans, and improved governance and economic strategies (World Bank, 2014). For example, knowledge that the “Small Island Developing States (SIDS) emit less than 1% of global greenhouse gas emissions […] [and the] Pacific Islands produce less than a tenth of 1% of global emissions” (Ball, 2011, p. 3), provides a compelling reason to challenge the inequitable consequences of climate change impacts. Other long-term plans and strategies demonstrate an effort to promote long-term environmental sustainability, e.g. the recent Paris Agreement (2015) directing countries and institutions to acknowledge their global footprints; and, social and environmental
disclosure frameworks and mechanisms, e.g. the Global Reporting Initiative, Integrated Reporting and CDP, which encourage institutional reporting on aspects such as carbon and human rights impacts[8].

Empowerment in the industrial world is represented when individuals and groups are able to influence the scaffold. For example, recent developments in education in the Pacific Islands promote the development of human capital and programs to assist citizens to make informed choices on planning for and developing their lifestyle, markets, or migration plans (Findlay, 2011). The first ever free online Pacific Climate Change mini course is conducted by the University of the South Pacific’s Pacific Centre for Environment and Sustainable Development. In September 2015, there were over 1,400 participants from 55 countries, eager to learn the science of climate change, the vulnerabilities and challenges the Pacific Islands face and how to plan, adapt and build resilience (The University of the South Pacific, 2015).

A moral accountability resides in the ability to account for the future and the impacts of climate change. However, despite some positive actions, industrial worth remains threatened by global marginalization that exacerbates a lack of capacity to plan and contribute/receive political and social support; as well as, the uncertainty and ambiguity that comes with climate change science and migration. For example, the inability to predict the number of potential environmental migrants (IPCC, 2013), contested estimates of sea level rise (UN Habitat, 2009), and the fluctuating and short-term global approaches to combating climate change, e.g. the failure of the Kyoto Protocol.

6.3 Civic accountability
Marshall Island Minister de Blum claimed “displacement of people in our part of the world is terminal. You know, you lose your sovereignty, you lose your language, you lose your tradition, you lose you” (in Brown, 2013). Sovereignty and national solidarity as a general justification and citizen rights as an individual justification ensure place in the local and global civic world. In the case of the Pacific Islands, this is threatened by the dependence on (inter-) governmental and supranational institutions. While “every nation would like to think its fate rests in its own hands […] in the case of low-lying island states, this is simply no longer the case” (Kaminsky, 2013) as developed countries contribute to climate change impacts and also mitigation plans, as well as the amount of aid given to support the Pacific Islands. As an example, developed nations have committed to providing USD$100 billion in financial aid annually by 2020 (Venugopal and Terpstra, 2013); however, governments are fearful of having a “sugar daddy” to determine their fate (Marshall Islands Minister de Blum in Brown, 2013) and undermine national sovereignty.

President of the former Global Humanitarian Forum, Kofi Annan (2009) argues:

We live in a global village and we each have a responsibility to protect our planet. Isn’t it logical and equitable, therefore, to insist that those who pollute have a duty to clean up? Pollution by some affects us all. Every one of us needs to understand that pollution has a cost […] Least responsible for greenhouse gas emissions are the world’s poorest communities who suffer most from climate change. This is fundamentally unjust (p. iii).

Recent actions by Pacific Islanders indicate attempts to redress the inequity. For example, the first case of climate change litigation[9] came from Tuvalu in 2002 in a suit for legal compensation against the USA, the then largest total emitter of GHG emissions and Australia, the then highest per capita emitter of GHG emissions (Jacobs, 2005; Kaminsky, 2013; Seneviratne, 2002). However, the International Court of Justice cited the unlikeness that Tuvalu would win against the powerful countries and the case was dropped (Kaminsky, 2013). More recently, in 2011, the Republic of Palau approached the International Court of Justice to seek advice on the “No Harm Rule”[10]; asserting states
have a duty to prevent, reduce and control the risks of environmental harm to other states, especially where breaches are found and measures to mitigate are unknown (Boom, 2011). Despite legal attempts, there is yet to be a successful climate change legal case as it remains difficult to place the blame or direct responsibility for the local effects of climate change (Scholz, 2012).

Boltanski (1999) argues that generalizations about the unfortunate create a suffering, distant other. For the purposes of this paper, the civic “body” is characterized according to the principles of human dignity as espoused in the Universal Declaration of Human Rights[11] (1948), including the “right to life” and “the right to a standard of living adequate for the health and well-being.” As a result, body displacement is evident in the institutional categorization and western language of the “other” as a tarnished citizen, e.g. “Tuvaluan” vs “migrant,” “I-Kiribati” vs “refugee,” or “Samoan person” vs “climate-displaced.” These labels are reinforced in instruments such as The Convention and Protocol Relating to the Status of Refugees (UNHCR, 1951)[12]; Migrators (Black et al., 2011b; Shen and Binns, 2012[13]; and, Guiding Principles on Internal Displacement 1998[14] (Foresight, 2011; Guterres, 2009). Paradoxically, the absence of a specific category for this vulnerable group of environmental migrants has resulted in global settlement programs that are often skewed to skilled and humanitarian migrants (Lehman et al., 2016; United Pacific Voice, 2012):

Displacements refer to people’s actions inasmuch as they are not categorized and, more especially, in so far as they do not form part of established and identified and highly categorized tests – a feature which gives them a local, largely invisible character (Boltanski and Chiapello, 1999/2007, p. xxvi).

The final example of Pacific Island solidarity is Tuvalu’s attempt to become one of the world’s first countries with zero carbon output by replacing fossil fuels with renewable energy (Malkin, 2009). Although Tuvalu’s GHG emissions are microscopic compared to other countries, the project is a positive step as it provides institutionalized accounts in international negotiations, and provides evidence that countries can be powered by natural resources (Malkin, 2009).

6.4 Fame accountability

A *SPOTLIGHT* or headline satisfies the (often) fleeting and ad hoc formation of fame worthiness and a deficient state is experienced when news, information and a public arena are absent. Boltanski and Thévenot (1991/2006) and Bauman (2000) indicate that the “ loudest” voices in society are most (fame) worthy, or have the greatest power. Therefore, accounts that inform public disputes, whether positive or negative, will generally emanate from global leaders and institutions. Annan (2009) argued this is already evident as the human impacts of climate change have largely been overshadowed by robust debate on the physical impacts or consequences to the economy.

Fame worthiness in the Pacific Island case is further deficient because of the slow onset nature of sea level rise (McAdam, 2011), and the small size and remoteness of the Pacific Islands (World Bank, 2015). As a result, accessing the spotlight, and gaining substantial public attention on the dire situation is challenging. While many Pacific Islands have begun speaking up in the media and in international debates, e.g. calls to end coal mining and to take a more aggressive approach to reducing climate change, many remain unable to access the global stage (Morton, 2015). Notwithstanding, Reverend Lusama encourages this engagement:

Tell your story to everyone, everywhere you go, to help them understand that this is an unfolding tragedy for ALL of humanity; not just for some nameless and faceless “others” in some far away land (Reverend Tafue Lusama in Corrie and Arawaks, 2009, p. 3).
Place in the international arena and media also relies on an ability to contribute to a public issue, receive desired information and voice an opinion. Therefore, fame accountability is evidenced by media accounts and other public stories and forms of engagement where the actor has a public platform to tell a story. NGOs, such as Pacific Calling Partnership[15], contribute to transparency and public awareness:

Imagine how you would feel if this was happening to your homeland? [...] And the reason was out of your control [...] We need to take action now (Ball, 2011, p. 1 and 5).

Other forms of accounts are emerging that attract spectators and therefore render a place for the voices of Pacific Islanders. For example, Farbotko’s (2005, 2010) studies on media attention for the plight of Tuvalu identified a vulnerable place; disempowered and sheltered by tragedy; a tropical paradise; and, a paradise lost to global warming (Farbotko, 2005).

6.5 Domestic accountability

Domestic worthiness is examined according to place or positioning in various hierarchies, including family, community, tradition, and property. While emphasis is given to historical accounts and actions, contemporary changes can both strengthen and stabilize hierarchical relationships, or establish displacement through the separation or lessening of one’s position. The Pacific Islands have been populated for thousands of years, and their identity and much of its people’s ancestry is connected to the land (Ball, 2011). This diversity is reinforced by a Fijian community leader:

For centuries, our societies in the Pacific have existed in small communities, often quite isolated from each other. This is manifested by the number of languages spoken in the islands of Melanesia [...] Each community retains shared ownership of resources, and has developed a culture that reflects its close relationships to its environment and the cycles of nature. This means that every language group, representing a discrete and isolated community, also has its own culture [...] and separate identities (Siwatibau, 1997, p. 165).

Each island community has a unique vision of a just society and prioritizes its own domestic conditions. The Chair of the Alliance of Small Island States argued:

We haven’t looked into the aspect of migration. I think we all are proud islanders and it’s not that we want to just look for another place to migrate to. No, what I think that we want is more how we can protect our islands, how we can ensure the sustainability of our islands, how we can ensure the survival of our community (McNamara and Gibson, 2009, p. 481).

Migration will ultimately result in displacement by physical separation and the potential loss of historical relationships of community strengthened by cultural traditions. Therefore, Island leaders enact adaptation plans according to their cultural needs. For example, Kiribati President, Anote Tong, with the rising threat of sea level rise induced displacement, has purchased Fijian land to relocate his entire nation (Pula, 2014). In other states, Island leaders have expressed their wish and determination to remain on their islands to preserve community (Boyer, 2013). For example, in Tuvalu, citizens agree that “[relocation] is not a good solution for us. Our people love their country, our people love their culture, and they want to stay and die on their mother land.” (Seimila Filioma in UN Women, 2014).

Therefore, each Pacific nation renders a unique understanding of place, whether that is a cultural place in maintaining community traditions or adaptation and ownership that secures geographical place.

Small-scale geographical displacement in the Pacific has already occurred. For example, small cases of community movement in Papua New Guinea (Box, 2009) and Taro (Morton, 2015), and in New Zealand, where visas have been given to (predominantly) skilled and educated Pacific Island immigrants (Bisley, 2008). However, as more severe consequences of
climate change evolve, large-scale migration and relocation will become necessary. Pacific Islands fear that relocation will be one of hardship, trauma, and insecurity (PCC, 2013), conflicting with inspired and domestic states of worth. And further, that relocation will disrupt the unique culture and tradition, including traditional skills, community structures, sites of worship, ceremony (IPCC, 2007), and the traditional way of life and food sources (Nunn, 2013).

6.6 Inspired accountability

Place is distinct in the inspired world and is dependent on an individual and the ability to feel and reflect. Therefore, to render a state of worth, individual justifications for the common good of imagination and belief are sustained through the individual testimonies or micro-stories in the local context. An inability to express spirituality through accounts is a state of deficiency or displacement.

Religion, Christianity in particular, is central to the Pacific Islander identity (Robbins, 2009). Stories from Tuvalu are evidence of inspired worth, e.g. Tuvaluan Emilio Eliapo believes:

the only thing we have here in Tuvalu is to pray. We are a very small island and very poor (in Siegel 2012, p. 26).

And further, Tuvaluans believe that God will support them:

This place will be safe. This is our belief […] I'm not worried. I mean, God created this place, and what for? What for? So we could live here (Tuvaluan resident in Mortreux and Barnett, 2009, p. 110).

Finally, the name “Tuvalu” means “eight standing together,” and represents a metaphorical bond and collective sense of belonging with others (Farbotko, 2005, p. 280).

The biblical story of Noah’s Ark is an account reflective of climate change and the hope that that God will control the floods (sea level rise) (Mortreux and Barnett, 2009). When asked what God thought of global warming, Reverend, Tanei Letueti replied – “if God’s will is for the island to sink, then it will sink. But it’s not the end of the world, because God already has a plan for us” (Siegel, 2012, p. 29). These accounts indicate a priority for the spiritual in the inspired world. And further, the necessity to include personal and reflective accounts to ensure moral accountability.

Inspired worth is also found in a sense of security or sanctuary where a deficient state is indicated by anxiety:

We live in constant fear of the adverse impacts of climate change. For a coral atoll nation, sea level rise and more severe weather events loom as a growing threat to our entire population. The threat is real and serious, and it is of no difference to a slow and insidious form of terrorism against us (Saufatu Sopoanga in Hunt and Mandia, 2012, p. 86).

This fear of physical and cultural death via migration is exacerbated when one considered examples of immigration policies. For example, Australia supports the principles of multiculturalism, immigrant participation and equality, which allows migrants to pursue their religion, language, and establish communities (Castles et al., 2012). However, in practice, immigrants are actually requested to integrate into society (Annisette and Trivedi, 2013), “core cultural values” and, in this case, become as “Australian as possible” (Castles et al., 2012, p. 15).

6.7 Green accountability

When Latour (1998) introduced the need for a green dimension, a specific philosophical tradition was not identified. He argued that understanding ecology as an individual order
exposed the relevance of biodiversity and the relationship between an ecological foundation and the current and future, local and global generations. While deep-ecology assumes nature is the center of all justifications, Latour (1998) rejected this principle for several reasons including his belief that ecology and sociology or human interaction cannot be separated. He argued that the human race should not perish for the sake of nature or the environment because humans have the ability to manage, control, protect, and monitor the environment under certain circumstances (Latour 1998). Therefore, we have adopted a perspective from social ecology as a body of ideas that “envisions a moral economy that moves beyond scarcity and hierarchy, toward a world that reharmonizes human communities with the natural world, while celebrating diversity, creativity and freedom” (Bookchin, 2005, p. 85-87). Place in the green world is conditioned to the ideals of social ecology, where humans co-exist with nature, albeit in a hierarchical position. Displacement occurs when the inter-dependent relationship between humans and nature is disrupted, which in this case will occur when the Pacific Islands are consumed by the sea. Accountability for green worth is evident in sustained human interactions that are harmonious, respectful, and protect the environment.

Accounts include visual images of a pristine environment. They often promote the vision of a “paradise,” “uniqueness,” and rich biodiversity that compromises with market worth (tourism) and industrial worth (fishing and agriculture). For example, the mangrove forests create homes for animals and act as a defense to protect communities from storm surges and coastal erosion (Namakin, 2007). The preservation and conservation of the turtles, whales, wrasse, and sharks indicate respect for the role they play in the culture, myths, legends, and traditions (World Wildlife Fund, 2013) that are integral to domestic and inspired worth.

However, the reality in the Pacific Islands is a story of poor water conservation, exploitation of fishing limits, ocean acidification, degradation of reefs, and the severe loss of mangrove forests and fauna, including reptiles, mammal species, and birds as a result of climate change (Secretariat of the Pacific Regional Environment Programme, 2012). For example, an individual islander identifies the impact of climate change on the fishing industry, suggesting: “It now takes 4 times longer than before to fish and, according to fishermen, reef fish are getting smaller. Fishing grounds have moved further away from shore and with increasing oil prices, a day without any fish in the nets is a calamity” (Alofa Tuvalu, 2005).

Justification of green worth is continually tested because 70 percent of the world’s natural disasters occur in the East Asia Pacific region (World Bank, 2015) and sea level rise is greater in the Asian (Stern, 2007) and Pacific Island regions (IPCC, 2001). The Pacific Islands are home to over 4,000 species of plants and animals (Ball, 2011). Yet, as Ball (2011) argues, you can relocate people, but in the case of sea level rise, where do you put the flowers, or the sounds of unique wildlife?

7. “Close your eyes and tap your heels together”

It is now the year 2090, I remember my grandmother telling stories of her childhood and the disputes over this phenomenon called climate change. She recalled the absence of long winters, the migration of people from hotter parts of the world having to move to “colder” regions just to survive, the vicious and fierce scientific and political debates about the effects of industry and the “first world” or developed nations on the global “other”. It was not until people and their homes were actually drowning that they had to find a new place to live. And in this new place, also a new way to worship, to preserve the memories of the past, to find work and employment in industries they were totally unskilled for and to live with an new language and a way to communicate. In this new place, they had no citizenship, no rights to come and go without government approval but they had a home. There is no place like home […].
The aim of the paper was to understand the challenges of the Pacific Islands in relation to (dis)placement, and explore how accounts inform accountability in a meaningful way. Just as folk tales approach the relationship of component parts as a whole or complete story to make sense of complex and disputed scenarios (Morrell and Tuck, 2014), we also provide an imagined story. As MacIntyre (1981) argued, understanding existence requires uniting the fragmented narratives of individuals. However, what do the fragmented accounts from SOW’s seven orders tell us about a holistic narrative of accountability for the Pacific Islands and climate change displacement? Even Boltanski and Thévenot (1991/2006) recognized the limitation of a narrow focus on a situation and the difficulties of differentiating individuals’ lives. While SOW does provide scope for compromises as demonstrated by the reliance on environmental sustainability (green worth) to sustain tourism (market worth), we cannot neglect globalization as a meta-narrative. In particular, the SOW analysis found that economic relations – market and industrial worth – has produced a situation where Pacific Islanders are susceptible to global marginalization (Bauman, 2000); global development that exacerbates climate change (IPCC, 2013); global governance and the inability (or lack of aspiration) to control markets and climate change contributors (O’Connor, 2013); and, diminishing local markets. The economic private interest and short-term, global economic focus has contributed to the dire conditions in the Pacific Islands.

In accordance with Bauman’s (1998, 2000, 2001, 2002, 2007, 2011) understanding of the contemporary global narrative of neoliberalism or, as Boltanski and Chiapello (1999/2007, p. 10) spoke of as a “dominant ideology,” capitalism has the power and driving force of the ideals of efficiency and profit maximization, which conflicts with communities (domestic world), the environment (green world), individuals (inspired world) and broader society (civic world). Further, legitimate justifications, business agendas and social norms for past, present, and near future actions fail to account for the Pacific Island(er)s in terms of disruptions to place. As a result, Pacific Islands experience marginalization by the policies that favor migration, physical, spiritual, and cultural disruption as a “desirable path.”

We began the paper by considering four contributions. First, we articulated displacement by using the body as a construct or metaphor for objectified existence across multiple dimensions of physical or non-physical attributes and time and space. As an empirical sociology, the Pacific Island case exhibited different compromises and modes of accounts to achieve a just outcome. Therefore, the second contribution was fulfilled by considering accounts explicitly linked and specifically anchored in seven evaluation regimes of place. Since these accounts are evidence of a regime of justification and an intelligible narrative of lived experience they have a moral dimension and provide a moral accountability. We have contributed to the accountability literature by considering how the SOW framework could be used to explore other issues, such as the current refugee movement in Europe or broader cases where human rights are tested. This approach taken can be applied in other global issues of disaster or displacement by anchoring the local conditions of place in Bauman (1998) and Boltanski and Chiapello’s (1999/2007) reflections on capitalism as a new order of power relations or regime of justice that subsumes the traditional domestic order.

Finally, this paper has contributed to the stories that “ask that we see differently, to be informed differently, engage our minds while stepping outside accustomed patterns, allowing us to think anew” (Dillard and Reynolds, 2011, p. 493). In the case of the Pacific Islands, the future story is of sacrifice, suffering, and uncertainty. And, like all lived experience, is messy, complex, and transitory. Therefore, we draw on the notion of “distant suffering” (Boltanski, 1999) to overcome this limitation to imagine the injustices
felt by others. At a generalized or universal level, Boltanski (1999) argued that the privileged actors only feel pity for the distant other when their misery is made public, otherwise there remains a moral blindness toward their suffering. It is not until we act that a case of suffering is localized. Therefore, the issue of the distant other can be overcome by deliberate imagination and reporting through speech as action. The “localized” story and the future as an investment formula, or that which is sacrificed in order to maintain a relation of worth, is a positive step toward accounting for (dis)placement and other complex challenges.

8. Post-face
In the face of climate change induced sea level rise, the Pacific leader, Epeli Hau’ofa (1994) in Our Sea of Islands, re-conceptualizes the Pacific as connected, as opposed to separated. He writes that the Pacific and its citizens have been “belittled” [displaced] by international systems, viewed as too isolated and too poor of resources to rise above international dependence. Initially Hau’ofa (1994) agreed, however, the bleak view on existence haunted him; he argued “in propagating a view of hopelessness, I was actively participating in our own belittlement […] Belittlement in whatever guise, if internalized for long, and transmitted across generations, may lead to moral paralysis, to apathy, and to the kind of fatalism” (p. 151-152). He empowers the Islanders to imagine the Pacific not as “islands in a far sea”, but as “a sea of islands” (Hau’ofa, 1994, p. 152). In this place (in a physical or spiritual sense), there is always a state of worth:

Wherever I am at a given moment, there is comfort in the knowledge stored at the back of my mind that somewhere in Oceania is a piece of earth to which I belong. In the turbulence of life it is my anchor. No one can take it away from me. I may never return to it, not even as mortal remains, but it will always be homeland (Hau’ofa, 2000, p. 470).

Hau’ofa’s (2008) account represents the value in leadership, empowerment and togetherness, as his people “plan for generations, for the continuity and improvement of their families and kin groups” (p. 38); “Oceania is hospitable and generous, Oceania is humanity rising from the depths of brine and regions of fire deeper still, Oceania is us. We are the sea […] We must not allow anyone to belittle us again, and take away our freedom” (Hau’ofa, 2008, p. 39).

Notes
1. Australian Prime Minster, Malcom Turnbull, ratified the Paris climate change Agreement on November 10, 2016. This action represents a commitment by Australia, and the other 103 country signatories, to reduce GHG emissions; largely through climate and energy policies, research, technology and innovation.
2. Boltanski and Thevenot originally presented the orders in 1991; however, we refer to the English translated reference in 2006.
3. Boltanski and Thévenot (1991/2006) in On Justification identify polities as the foundation for SOW. These are referred to in other studies as worlds, orders of worth, economics of worth or a model of legitimate order that identify “the requirements a higher common principle must satisfy in order to sustain justifications” (Boltanski and Thévenot, 1991/2006, p. 66).
4. A CSIRO study from 1993-2010 showed the global distribution pattern of sea level rise greatest in the Pacific Ocean, followed by the Indian ocean: some above 10 mm/year.
5. While we present the Pacific Islands as a collective group, it is a large and diverse region that consists of multiple nations, and differing socio-political and legal status, traditions, communities and cultures. In addition, each nation will experience varying impacts of climate change and the Pacific Islands.
change based on their geographical features (Tisdell, 2008). Therefore, we do not attempt to include every example, available discourse, theme or nation within this case. Instead, we provide empirical material for a number of key themes that support the potential displacement and moral argument of each SOW world.

6. While Myers predictions are over a decade old, they remain the most cited/referred to in the associated contemporary literature, including the IPCC.

7. The “news” is the end-product of a complex process which begins with a systematic sorting and selecting of events and topics according to a socially constructed set of categories (Hall et al., 1978, p. 53). The media does not report events as they occur naturally (Hall et al., 1978), but generates public opinion to produce an external identity and story. Each report/news story presents an intelligible account by increasing public engagement and recognition, giving respect for the actors or events, and ensuring full public disclosure and accessibility to analyze and draw conclusions.


9. Climate change litigation refers to lawsuits that have arisen from activities that: have damages from global warming; failure of government to protect their citizens; and, industries suing government over increased regulation (Scholz, 2012).

10. The “No Harm Rule” was established in 1941 after a Canadian Cooper Smelter was found to be polluting US air, evidence did not have to be given that actual harm arose, it was sufficient to show that there is a risk of harm (Boom, 2011). It suggests that climate change is not the result of a deliberate act, but rather the cumulative effect of non-criminal social and economic choices and activities (Boom, 2011).

11. The UDHR is an internationally agreed standard promoting basic rights and freedom to all humans. It is not a treaty, and therefore, not legally binding, however, the values and fundamental principles it encourages are shared globally (Australian Human Rights Commission, 2011).

12. However, the “refugee” status is contested as it does not include environmental displacement and bears an unwelcome stigma (Burson, 2010; Guteres, 2009; Locke, 2009; McNamara, 2006; McNamara, 2007; UNHCR, 2010).

13. These include individuals who choose to re-locate due to changes in demographics, culture, social and economic aspects, and stress or uncertainty.

14. These principles were presented to the UNHCR in 1998 and have been recognized by the general assemble. They account for internal involuntary displaced persons, however, Pacific Island migration due to sea level rise will be external.

15. The PCP aims to raise awareness, encourage support for climate change, provide a mode of communication through media access and most specifically to “listen and be accountable to voices from the Pacific” (Pacific Calling Partnership, 2014, n.p.). See www.erc.org.au/

16. The definition of a “paradise” is broad and subjective, often referring to religious language, a heaven, a place of bliss.

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Further reading


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The impact of accounting standards on hedging decisions

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Abstract

Purpose – The purpose of this paper is to study the effects of financial accounting standards on the economic decisions of managers. The primary research question addressed in the paper is whether the hedging behavior of corporate treasurers in France has been affected by the issuance of International Accounting Standard No. 39 and International Financial Reporting Standard No. 9 dealing with financial instruments and hedging.

Design/methodology/approach – In all, 48 semi-structured interviews were conducted with French corporate treasurers. The interview instrument is included as an exhibit to this paper. The interviews were recorded and transcribed. In addition, three interviews were conducted with representatives of Big 4 audit firms who are experts in accounting for financial instruments. The empirical findings are interpreted using a theoretical framework derived from Jean Baudrillard who argues that the “map” (accounting results) tends to define the “territory” (economic decision-making) in a period of “hyperreality” (when the underlying economic reality is confused). In other words, accounting standards, and the reported numbers that result from such standards, can influence the economic decisions of managers and not merely represent the outcome of economic decisions already taken.

Findings – Corporate treasurers often make decisions based on earnings impact. This finding is similar to findings in prior literature regarding the effects of accounting standards on economic decisions taken by managers. A fear of increased earnings volatility is central to the treasurers’ concerns. Also key is the complexity of the process for qualifying financial instruments for hedge accounting treatment. The authors also find that the behavior of corporate treasurers is neither stable nor homogeneous. The behavior appears to be the outcome of a collective learning process in which the corporate treasurer is only one actor.

Research limitations/implications – The type of qualitative research undertaken in this study has its limitations. It cannot be demonstrated that the findings are generalizable. There is a contextual specificity to the treasurer’s function, which reinforces a particular focus on accounting results. The CFO is simultaneously the superior of the treasurer and responsible for financial reporting, and consequently subject to a conflict of interest that does not necessarily apply to other types of managers. Therefore the findings cannot apply to all managerial functions.

Practical implications – The authors found that corporate treasurers focus on accrual-based earnings despite engaging in a function that is supposed to focus on cash flows. Even if the IASB believes that accounting standards should be used primarily by investors and creditors, they should acknowledge that there is a fear of earnings volatility by managers, and that there is an temptation toward increased use of other comprehensive income as an alternative to reporting volatile earnings numbers.

Originality/value – This paper is a qualitative research study conducted in an area of research where there have previously been only quantitative studies. The access to a large number of French corporate treasurers is unique. The study supports prior findings regarding the influence of accounting standards on managerial behavior, but with an added theoretical interpretation related to Baudrillard’s arguments regarding the nature of the “map” and the “territory” in complex economic systems.

Keywords IFRS, Territory, Accounting standards, Hedging, Corporate treasurers, Map

Paper type Research paper

1. Introduction

Beyond its stated objective of representing the economic reality of business transactions, accounting can also act in a reverse manner. This observation is encapsulated in the phrase by Hines (1988) which states that: “in communicating reality we construct reality.”
This constructivist interpretation of accounting has been investigated in the accounting literature by various authors who often refer to “postmodern” thinkers (e.g. Chiapello and Baker, 2011). For example, Jean Baudrillard’s theoretical notion of “hyperreality” has been applied to the notions of income and capital, which can be seen as self-referential signs where “the map begets the territory” (Macintosh et al., 2000, p. 32). Interestingly, however, this theoretical approach has resulted in little or no field-based empirical research. The present paper aims to fill this gap by providing an empirical example of the impact of accounting standards on the economic decisions of field managers.

In our study, the field managers are corporate treasurers. In specific terms, we investigate how a mandatory change in accounting standards for derivative instruments – principally IAS 39 and IFRS 9 (IASB, 2010) – has redefined the accounting “model” (i.e. the accounting standards) that must be followed when preparing the “map” (i.e. accounting results) of the economic “territory” (i.e. economic decisions). Our research provides support to those who argue that international accounting standards mandating fair value accounting have had a negative pro-cyclical impact on the real economy[1]. Our study provides some support for this thesis in that we find an impact on corporate treasurers’ economic decisions arising from accounting standards. The impact appears to be related to a fear of earnings volatility. In addition, we find a complex and nuanced process, with heterogeneous behaviors and dynamic learning processes. Once they have acquired agility in dealing with the new accounting standards, some treasurers are in a position to engage in earnings management to reduce earnings volatility.

The approach of this paper is original. Whereas most prior literature has studied the influence of accounting standards on the users of financial information – especially investors and financial analysts – our purpose is to study the impact of accounting standards on the economic decisions of managers. We have used semi-structured interviews to elicit responses regarding the hedging practices of corporate treasurers subsequent to the implementation of IAS 39 and IFRS 9. We find that the treasurers perceive an impact of the accounting standards on their hedging practices, even if there is no consensus about the nature of this impact. We show how the “model” (i.e. accounting standards) that prescribes how the “map” (i.e. accounting results) ought to be drawn influences the “territory” (i.e. economic decisions) in which the treasurers operate.

The remainder of this paper is organized into five parts. To begin with, we illustrate our theoretical framework derived from Baudrillard’s concepts of “model,” “map,” and “territory.” In explaining these concepts, we mobilize prior literature related to the topic and show how previous research has studied the ways in which changes in accounting standards impact upon managers’ decisions. The second part focuses on the specific case of corporate treasurers and discusses our research methodology. In the third part, we present our findings and the fourth part we discuss our findings in relation to the theoretical framework. Limitations and extensions of the research are discussed in the conclusion.

2. Theoretical framework: the territory, the model, and the map

2.1 The relationship between financial accounting and financial markets

Can a territory be represented faithfully by a map? This logical puzzle – reflected in works such as those of Lewis Caroll or Laura Riding[2] – addresses the timelessness of the signified/signifier relationship and is sometimes referred to as “the quintessence of Anglo-American philosophy of common sense” (Siegert, 2011). Authors like Jorge Luis Borges (1949) and Umberto Eco (1992) have discussed the challenges involved in creating maps to embody physical and social realities and they have criticized the attempt to draw a map which purports to represent a territory.

From another perspective, that of academics in geography and anthropology, the conundrums of the map-territory relationship have been classical questions. Academics in
these disciplines typically consider maps either as social constructions (Crampton, 2001), narratives (Wood and Fels, 1986), or metaphors (Harley, 1992). Their research concentrates less on the relationship between the map and the territory than on the unachievable ambition of using a map to faithfully represent a territory: a map needs to be understood as more than an attempt to represent reality; it must tell its own story.

It is precisely this fuzziness between faithful representation and reality, which the French author Michel Houellebecq (2010) explored in his novel “The map and the territory” which blends references to real events with fictitious narratives in order to shape a hyperreal story. The main character of the novel – an artist – owes his celebrity to photographing Michelin maps, convinced that “the maps are more interesting than the territory.” This interesting notion reflects the prior ideas of René Magritte, a Belgian Painter, who coined the phrase: “This is not a pipe,” several years before his famous aphorism reached its most commented upon status through Korzybski’s (1933/2007) dictum: “The map is not the territory.” For Korzybski, a map needs to take on a structure that is comparable to the empirical world, but the map also needs to explain how it must be interpreted. These constraints can be expressed in three sayings: a map is not the territory (words are not the things they intend to represent); a map (words) cannot exhaustively cover the whole territory; a map is auto-reflexive (it is possible to use a language to speak about language) (Korzybski, 1933/2007).

Pursuing these ideas further, the French social philosopher Jean Baudrillard coined the concept of “hyperreality” in which he argued that there may be no reality underlying the map. Originally interested in semiotics, Baudrillard developed a sociological approach to mass communication, and he specifically argued that the communication methods prevalent in a particular society shape the social relationships in that society. His analysis of the famous Beaubourg Museum in Paris and Disney World illustrates that beyond the blending of the map and the territory, there appears to be an emergence of signifiers referring to no reality at all. Baudrillard theorized the existence of four successive phases of signification (i.e. orders of simulacrum): “brut reality,” “when images reflect what is considered to be real”; “counterfeit reality,” “when images pervert the basic reality”; “mass production” of images, “when images hide the underlying reality.” Finally, references to the original reality are lost, “the image bears no relation to any reality at all: the image is its own pure simulacrum” (Baudrillard, 1981 p. 17):

“Today, abstraction is no longer that of the map, the double, the mirror, or the concept. Simulation is no longer that of a territory, a referential being or substance. It is the generation by models of a truth without origin or reality: a hyperreality. The territory no longer precedes the map, nor does it survive it. It is the map that precedes the territory – that engenders the territory Baudrillard (1981, p. 10, 1994, p. 1).

Baudrillard’s work has drawn the attention of various accounting academics. For example, Macintosh et al. (2000) described the evolution of financial accounting as moving through the phases hypothesized by Baudrillard (Figure 1).

Macintosh et al. (2000) argued that accounting for financial instruments has arrived at a stage of hyperreality. This argument is illustrated through a feedback loop in which information extracted from financial statements is used by financial analysts to estimate share values, which subsequently drive share prices. This latter information re-enters the balance sheet as marked-to-market values. The feedback loop (see Figure 2) illustrates the dual relation between the sign and the object, similar to what Baudrillard describes as a “simulacrum.” To Macintosh et al. (2000, p. 36) “The market uses accounting earnings, along with other information, to value company shares and other securities. The prices of the securities then become the “underlying” that sustains the derivative prices and the self-referential sequence is complete.”
The user of the map is the analyst or investor. The standard setter/regulator (IASB, FASB, SEC, etc.) prescribes the map’s “model” through the issuance of accounting standards. The standard setters attempt to create a model based on representational faithfulness, but this attempt is unsuccessful, because the managers modify the “territory” (i.e., economic decisions) in order to influence the outcome of the “map” (i.e., accounting results).

Macintosh et al. (2000) propose a feedback loop which produces a continuous update of the model[3]. If, however, the territory enters a crisis phase, unreliable maps may be the result, which causes users to make erroneous decisions, either in an overly conservative manner or in an overly exuberant manner. Naïve interpretations of optimistic maps can lead to irrational
investment decisions thereby contributing to economic bubbles. At the same time changes in the rules for mapping (i.e. the accounting standards) may lead to instability in the territory (i.e. economic decisions). An example of this instability occurred with the adoption of IFRS 9 which might have amplified the financial crisis of 2008 by contributing to the creation of a bubble when the market was buoyant and accentuated crises of confidence when market liquidity was limited[4]. On this topic, there is, however, no clear consensus (e.g. Barth and Landsman, 2010; Badertscher et al., 2012; Brüggemann et al., 2013).

Pursuing this idea further, Macintosh and Hopper (2005) have argued that corporate economic performance no longer relies on the exploitation of tangible resources, but rather on the ability of managers to manipulate the images of intellectual capital. Libby and Seybert (2009) confirmed this idea with a focus on accounting choices as vectors of earnings management.

2.2 Prior research on the impact of accounting standards

Many prior empirical qualitative studies have examined the influence of accounting standards on managerial decisions. For example, the implementation of SFAS 106 “Employers” Accounting for Post-retirement Benefits Other Than Pensions’ in 1992 resulted in private sector employers reducing their commitments to health care coverage for their retired employees (Fronstin, 2000), because the new standard required the recording of the present value of future liabilities in financial statements.

More trivial accounting choices may include, for example, amortization methods. Jackson (2008) and Jackson et al. (2010) shed light on the distorted representation of assets depreciated on a straight-line basis vs accelerated basis: when accelerated depreciation was applied, fixed assets were sold at lower prices than similar assets that were depreciated on a straight-line basis.

More closely related to the theme of our paper, Kim and Kross (1998) found that a 1989 regulation had divergent impacts on loan provisioning based on whether banks had high or low capital ratios. In the same vein, SFAS 114 (dealing with problem loans) was found to have an impact on decisions according to size and types of banks (Alali, 2005; Alali and Jaggi, 2011).

These findings are consistent with earlier findings such as those of Wiener (1982) who designed an experiment to evaluate the impact of SFAS 8 on the behavior of treasurers in order to assess information inductance[5] (Prakash and Rappaport, 1977). Pursuant to SFAS 8, which requires using the temporal method for consolidating the figures of subsidiaries operating in foreign currencies, the author found that treasurers engage in hedging transactions which sacrifice cash flows for the benefit of earnings, because the latter are more crucial to maintain their positions. More recently, Zhang (2009) points to an interesting impact of a change in the SFAS 133 standard on derivatives, a 1998 standard which anticipated, for US firms, several changes later introduced by IAS 39. SFAS 133 distinguishes between financial instruments that create an effective hedge of interest rate and foreign exchange risk and those that do not, and applies a different accounting treatment for effective hedges. Zhang (2009) found that only firms whose exposure did not decrease after the implementation of the derivatives program significantly reduced their risk exposure following the issuance of the new standard. In addition, Lobo and Zhou (2010) point to an impact of the US Sarbanes-Oxley Act (SOX) on financial reporting for a panel of Canadian companies listed in both Canada and the USA. Their study found that firms are more conservative after the implementation of SOX, as evidenced by smaller amounts of discretionary reserves. The effect is even more pronounced for firms that previously had aggressive behavior.

Our paper contributes to the findings of the prior literature, but it is also different from the prior quantitative empirical papers through its effort to examine actual behavior. While most empirical studies lead to weak inferences, we adopt an explanatory approach (Creswell and Plano Clark, 2007). Our underlying premise is that differences in attitudes of
managers may be due to differences in perceptions and representations, the latter being influenced by a learning process. In accordance with this premise, we interviewed a panel of corporate treasurers whose corporations adopted IFRS. These treasurers were working in various contexts in terms of the size and the sector of their corporations. Our methodology and the context of our research are detailed in the next section.

3. Context and methodology
In this section, we present the methodology of our study. First, we provide some context about the job of the corporate treasurer. In particular, we clarify the linkage between his/her daily activity and accounting standards. Then, we introduce our research methodology.

3.1 Treasurers and accounting standards
The opportunity for this research came from the relationship of one of the co-authors with the AFTE, the French Association of Corporate Treasurers. With around 1,400 members, making it the largest association of treasurers in the world, the AFTE acts as an intermediary between corporate treasurers, market regulatory authorities, and governmental bodies.

The corporate treasurer is the operational manager of a company’s financial commitments. He/she is in charge of maintaining the corporation’s ability to face its financial commitments, especially in terms of liquidity. The treasurer is also responsible for implementing hedging policy by buying and selling derivatives (via banks) on financial markets, a task generally conducted under the supervision of the chief financial officer (CFO) who is in charge of the overall solvency of the corporation.

Since 2005-2006, French companies have been required to present their consolidated accounts in accordance with IAS/IFRS. This change was significant because French GAAP has been based more on historical values and fiscal rules than on fair value. IAS 39 and IFRS 9[6] set the rules for the recognition and measurement of financial assets and financial liabilities. The introduction of these standards changed the accounting rules for derivatives (e.g. forward exchange contracts, swaps, options, etc.). Until 2005, derivatives appeared off-balance sheet. The introduction of IAS 39 resulted in the reporting of these instruments on the balance sheet at their fair value – i.e. either their market value (mark-to-market) or on the basis of a financial model (mark-to-model) in the case of illiquid markets. Throughout the life of the instrument, the variation in fair value can lead to volatility in the balance sheet and in the P&L. To limit this volatility, the standard setter offers an alternative called “hedge accounting,” which requires a demonstration that the hedging position is highly efficient. The efficiency is measured by the sensitivity of the fair value of the hedging instrument in relation to the value of the underlying hedged item, and must fall in the range of 80-125 percent.

In this paper, we investigate whether the introduction of IAS 39 may be more than merely an accounting choice, since the economic decisions of the treasurers may also be affected. Basically, the treasurer faces a trade-off between the economic optimization objective and the accounting result. The treasurer’s actions can be considered “real earnings management” rather than accruals manipulation. The treasurer is not the only agent affected by accounting rules. The treasurer’s superiors – especially the CFO – are likely to interpret the constraints and opportunities in their own way, and auditors – internal and external – might also advise, if not impose, their own perspective. However, the treasurer is likely to be the person who defines the way to deal with these issues, especially in smaller entities where the treasury function is combined with the overall financial responsibility. Consistent with previous studies, one can therefore expect to find different reactions to the standards and differences in the demographic characteristics of the surveyed companies. This is where the potential richness of our research lies.
3.2 Research methodology

Our literature review shows that most academic work on this topic is either quantitative or experimental. Although these methods are rigorous, they do not provide an understanding of the actors' motivations. We seek both to fill this gap and to better understand the treasurers' behavior. To do so, we chose to conduct qualitative research, in line with the call by Arnold (2009, p. 804): “The need for financial accounting research to reduce its dependence on quantitative databases and develop the methodological tools, institutional knowledge, and links to practice needed to bridge the gap between academic research and the world of ‘accounting in action’ is one of the most significant challenges posed by the current crisis to accounting research.”

In a preparatory step, we asked the members[7] of AFTE the following question by e-mail: “Do IFRSs have an impact on your hedging strategy?” 56 percent of the 211 respondents answered positively. Such an observation confirmed our initial intuition of significant but non-homogeneous perceptions regarding this issue. Thus we moved to a second step, based on individual interviews (see Appendix 1 for the interview guide). Between June 2011 and March 2012, we surveyed 57 firms, with a sample designed to obtain cross-sectional differences in firm size. Because of the support of the AFTE, the response rate (91 percent) was very high with 52 treasurers agreeing to be interviewed. In all, 48 usable interviews (84 percent)[8] (listed in Table AI) were obtained, thus insuring against a non-response bias (e.g. Baker et al., 2011). The 30 minutes to one hour interviews were conducted either face-to-face or over the phone and were systematically recorded and transcribed before being analyzed.

Most of our interviewees were chief treasurers whom we met in person. In some cases – particularly in smaller firms – financial managers responded. Sometimes, at the initiative of the respondents, we met two interviewees simultaneously: the treasurer accompanied either by the accountant in charge of the treasury operations, the person responsible for consolidation or the CFO. The 48 interviews resulted in a saturation effect as defined by Glaser and Strauss (1967).

We adopted a semi-structured approach for our interviews. Frequently used by scholars in management and strategy (Eisenhardt and Graebner, 2007; Kownatzki et al., 2013), in-depth interviews are likely to identify the motivations of the treasurers with respect to their decision-making processes. A semi-open discussion also enables a better understanding of the perceptions of treasurers about their profession and its evolution. We are not observing the influence of a standard on practice but rather the impact of the standard, as it is perceived by the actors. For instance, several respondents who checked “No” to the initial question nevertheless confirmed during the interviews that their practices had changed. It is worth mentioning that the greatest care was taken during the interviews not to induce bias in the responses by avoiding words such as speculation, pro-cyclicality, or volatility.

During the interviews, three main issues were addressed:

1. The respondent’s opinion about the influence of IFRSs on the evolution of the profession of treasurer: this question was asked in order to prompt the treasurers to reflect upon the relationship between accounting standards and the economic decisions they made. We also wanted to investigate the impact of the standard on the treasurer him (her) self in order to study the learning process.

2. The relationship with his/her supervisors was discussed in order to assess the treasurer’s personal perspective on the constraints and guidelines imposed by his/her supervisors with possibly conflicting goals.

3. The role of internal and external actors involved in the implementation of IFRSs: this question was asked because IAS 39 and IFRS 9 deal specifically with hedging decisions. It was therefore important to understand how the internal actors...
implemented the standards. Again, this relates to the learning process. The external actors that we had in mind were external auditors, who also play a role in implementing the standards. We also wanted to discover whether the reaction to the standards was voluntary or proposed/imposed by the auditors.

We also used follow-up questions “to elicit richer and more detailed descriptions” (Kownatzki et al., 2013, p. 1301). Beyond the previously mentioned issues, more technical issues were discussed, such as: collateralization, standardization, training modalities, hedging instruments, etc. During this final phase of the interview, the treasurers frequently came back to the issue of accounting standards. Finally, we met three partners from Big 4 French audit firms, all of whom were considered to be experts in the field of accounting for financial instruments. Despite their desire to keep their comments anonymous, they generally confirmed the relevance of the material that we submitted to them.

4. Results
This section discusses our findings. We present the primary themes raised by our respondents, based on coding and analysis made by three different persons (two researchers and an assistant). Interpretation and discussion of these results are left for the fifth section.

From a demographical point of view, descriptive statistics suggest that respondents can be categorized into four types: the largest corporations belong to the French CAC40; the mid-size corporations belong to the Mid100; the small ones belong to the Small90; and the privately held companies (considered in a separate category called NL). Descriptive results suggest that the transition to IFRSs has affected financial risk management for 91 percent of CAC40 companies against only 50 percent for the other categories[9]. Within our sample, this difference is statistically significant. Conversely, there is no significant difference between the categories Mid100, Small90, and NL. Large firms of the CAC40 are more exposed to financial communication issues, because they are closely followed by analysts (Lang and Lundholm, 1996; Yu, 2008). Hence their CFOs are probably more sensitive to changes in accounting standards. As a consequence, their treasurers may internalize this sensitivity by modifying their behavior.

4.1 A perceived increase of earnings volatility
Our first finding is that there is a general acknowledgment of the impact of the accounting standards on their hedging behavior[10]; however, various justifications were advanced. The belief regarding an increased risk of volatility in the earnings statement appears to be quasi-universal, and mostly expressed as a fear: “We have been surprised about the effect of the time value of money and the obligation to account for this in the P&L. So we do not wish, in fact, to bring volatility into the accounts” (Interview 1 – treasurer at a large corporation)[11]. “Our role here is to eliminate risk, not to increase it. So anything that introduces volatility in the earnings is excluded” (Interview 2 – treasurer at a large corporation). Also, “It is somehow cultural, but I know that we are particularly allergic to volatility of the income statement” (Interview 3 – treasurer at a large corporation).

Sometimes our respondents internalized the views of analysts who were thought to be averse to any form of volatility: “We could not afford to leave it in the P&L because, for analysts, it completely distorts the analysis.” We were forced to put it in the non-operating income. Obviously, in the non-operating income, analysts do not like it either and they want you to explain it. They prefer you to say: “Here, there was a particular event during the period that caused the non-operating income to be this” (Interview 4 – treasurer at a large corporation).

Sometimes volatility is seen as a managerial failure which distorts budgeting: “We are in a group led by a budget cycle, where all the entities have budgetary commitments and do everything they can to meet these commitments. In this context, volatility is very
unpleasant. Because we may not be able to [...] uh, the manager may not be able to meet his targets [...]” (Interview 4 – treasurer at a large corporation). In the latter case, the treasurer internalizes the concern of the operational manager who is keen on meeting his/her targets, and who might not be able to do so due to the effect of an accounting standard on hedging that is beyond his/her control: “[...] everyone tends to look at what has an impact on the income statement rather than on equity. We can criticize this, because everything relates to the value of the company. But in fact, there is much more focus on what is happening in the P&L” (Interview 14 – treasurer at a mid-size corporation).

In such cases, the treasurers tend to impute to third parties – especially operational managers and analysts – a functional fixation bias (Hand, 1990) leading them to have a naïve interpretation of accounting results. Thus, the treasurer – supposedly focused on economic risks – focuses instead on the volatile P&L.

4.2 A perceived increase in complexity

In many interviews, IFRS were criticized for their deleterious effect on the treasurer’s mission: “We have become accountants” (Interview 5 – treasurer at a large corporation) and “It becomes more and more complex and we waste a lot of time in discussion with the auditors. Last year, we had a significant contract on yen. The accounting was so complex that we promised not to do it again” (Interview 6 – treasurer at a non-listed corporation). And “The accounting brings nothing to the treasurer. It is a total inconvenience [...]” (Interview 11 – treasurer at a mid-size corporation).

The complexity and the demand for documentation generated by IAS 39 and IFRS 9 are another effect deplored by respondents. This was even more pronounced in companies that have only limited accounting and financial expertise: “Even if it could be defined as hedging, we did not develop a justification scheme because it risked becoming too long and, indeed, we feared getting entangled” (Interview 7 – treasurer at a small-size corporation). In these cases, avoidance of complexity led to the treasurer accepting volatility.

As a corollary to this complexity, the standards create uncertainty due to the risk of having operations not qualified for hedge accounting. Interestingly, the auditor is the most cited partner in the process of implementation of the new accounting standards. However, experiences are sharply divided on this matter: some mentioned conflicts and considered the auditors to be overly rigid, while others described good relationships with the auditor. Therefore, the relationship with the auditors becomes critical especially because it is not static and can evolve favorably over time with experience and the provision of support in the interpretations of the standards. “[...] The fact that we use standard accounting throughout the year and then do the regularization based on foreign exchange transactions is thanks to our auditors because, in theory, we should account for our operations on a daily basis – that is what our American colleagues do” (Interview 6 – treasurer from a non-listed corporation).

A flexible relationship was confirmed by two of the three Big 4 auditors whom we interviewed. One acknowledged: “The text requires documentation and effectiveness assessments to be made concomitantly with the operation [...] But there is room for auditor’s judgment, on a case by case basis, when things have been done by the client who just forgot documentation. If everything else is OK, should we stand there and refuse to qualify afterwards? In fact, I personally agree [...] when I feel it is an omission and I tend to refuse it when it seems to me there is intentional earnings management” (Auditor 1).

Our results also suggest that there is room for discretion on decision making about qualifying an operation as hedging instead of speculation. However, the auditors we met showed some discomfort when addressing such issues. The relationship between the treasurer and the auditor has thus intensified: “We are obviously more in touch with our auditors who will come to analyze what we did” (Interview 2 – treasurer at a large corporation).
It is through the relationship with the auditor that some treasurers accepted the changes: “I think that IFRSs are a necessary evil, in the sense that there are some companies who abused derivatives and there was a need to put a little order in everything […] We could not afford to let companies set up trading portfolios or hedges, or hedges that are not hedges. So it was normal to impose a framework that allows us to get closer to accounting and to put all financial products in the balance sheet and the income statement” (Interview 1 – treasurer at a large corporation). This is also the case when accounting issues are explained to superiors: “The important thing is that our Chief Financial Officer knows how to explain; when there is an impact he explains it as if it is a non-cash impact” (Interview 8 – treasurer at a small-size corporation). This illustrates the role of the financial management function, which is expected to reconcile the concerns of managers (including general management) and those of the auditors (internal and external).

Even when giving positive opinions, the respondents tend to note that discussions and negotiations become necessary when they want to consider a transaction for hedge accounting: “In some cases, we have to explain and discuss, and then decide together on the trade-off between the impact of volatility on the accounts and the economic importance of the hedge, […]” (Interview 9 – treasurer at a large corporation). This tends to slow down the decision-making process, and may cause interesting hedging opportunities to be passed up. Some treasurers explicitly acknowledge this dilemma and admit that they come across situations in which they prioritize accounting results over the economic interests of the company. Interestingly, in our sample we find that the ways of adapting to the constraints imposed by the standards[12] are diverse.

4.3 Diverse ways of adapting

First, our results indicate avoidance behavior: “[…] the strategies that we had always practiced and that seemed economically viable, all of a sudden became impossible because of the presence of volatility in the P&L that was no longer bearable” (Interview 4 – treasurer at a large corporation). “Sometimes we say no, we will not do the operation this way because we will have problems with these rules and then we will waste a lot of time, and therefore […] we just get involved in traditional forward exchange transactions, whereas before we had practiced a few options with tunnels” (Interview 6 – treasurer from a non-listed corporation). Some companies decided to use simple options (“vanilla” in professional jargon), and gave up on more speculative operations. Macro-hedging strategies or dynamic management were less common because of the documentary complexity that they require: “We have to cover fifteen to twenty currencies and it is true that constraints imposed by IFRSs have led to a simplification of the hedging instruments used by the group” (Interview 12 – treasurer at a large corporation).

Less frequently, corporations dealt with the standards by publishing two sets of accounts: one that would be purely IFRS – including operations that have an impact on the P&L – the other set is adjusted. In one of those cases, the company had to convince the Financial Markets Authority (AMF): “The AMF, in fact, criticized us every time for the fact that we reported and communicated on adjusted accounts. And we had to fight, but they finally accepted it” (Interview 5 – treasurer at a mid-size corporation). Most often, this type of positioning reflected a collective learning process that involved higher level management, the authorities and auditors: “[…] there was some flexibility from the auditor, there were some differences in understanding from different parties, and as a consequence some behaviors were adapted a little bit” (Interview 1 – treasurer at a large corporation). “There was quite a lot of learning by the operational staff, and then learning at the senior management level, who also had to learn to read the accounts from a new angle and to be able to explain it to the investment community” (Interview 14 – treasurer at a mid-size corporation). In this context, the treasurer was never the sole decision maker.
A third category of respondents included firms that could be considered pragmatic or opportunistic. These firms were able to take advantage of IFRS in order to structure and standardize practices within the group, or to manage earnings, or to adapt themselves to events. This was present in a firm that voluntarily adopted IFRS in order to standardize accounting procedures and cash management in all of its subsidiaries (via the creation of a cash pool): “I think it’s still safer to be in a standardized environment in which each participant knows, applies and respects the standards. This helps greatly to clean up the entire system” (Interview 11 – treasurer at a mid-size corporation). In doing so, the group leader succeeded in reducing earnings volatility. This structuring effect is recognized as a positive result of the transition to IFRS: “The first effect was beneficial because it was a requirement for all units to report their exposures in order to be able to hedge them” (Interview 15 – treasurer at a large corporation).

Finally, a fourth category of respondents said they had not significantly changed their behavior following the introduction of IFRS. This may be related to the economic situation of these companies or to their capital structure: “At first, it did not change much since it was considered that the issue was still restricted at our level. We have not implemented hedge accounting, so we actually continue to do as we did. […] We are definitely a listed company, but with family control, so stable in terms of financial reporting; we are not in the same situation as a company that really needs to justify in detail […]” (Interview 10 – treasurer at a small-size corporation). Volatility seems acceptable as long as the firm does not feel obliged to explain it, especially since it saves the administrative costs of hedge accounting. It should be noted, however, that when this group became more internationalized and the treasurer had to deal with more exotic and volatile currencies (Russian ruble, Brazilian real), the attitude was revised: “The ruble fell flat. One year, it took 1.5 million unrealized mark-to-market gain. So it inflated our result with 1.5 million in one year. This was cancelled the following year by the accounting mechanism. These events brought significant volatility into the income statement. So, we asked ourselves whether it would not be interesting to look at this part of hedge accounting. In fact, we worked on it and we will put in place this year. It is being put in place in 2011” (Interview 10 – treasurer at a small-sized corporation). Thus, indifference to the standards may be temporary and difficult to maintain when volatility increases.

4.4 Other findings
Although the goal of earnings management is never explicitly admitted, it appears implicitly in several interviews: “The ultimate aim of going into hedge accounting is because this is what will enter into the operating income of the subsidiary, and this is what we at the central level present when we publish our results. The goal is not to make financial income […] We do not take that approach. We think that many groups do this […] That is to say they take a fairly aggressive approach and then might impose it on their auditor or, at least, convince their auditors that such positive operations will be considered hedging and will therefore enter into operating income, whereas other operations – those that are losing – will go into other income” (Interview 12 – treasurer at a large corporation). So there is a potential to delay or anticipate earnings and to transfer between operational and non-operational levels. In other interviews, other comprehensive income (OCI) is evoked as an alternative for hosting temporarily undesirable volatility. At the same time, one respondent tried to draw a line: “[…] in most cases we do not want to intervene in the operations, we don’t want to influence the business. Although, in some cases, we may show the potential impact in the accounts and it is said that it is not acceptable and undermines one transaction – this can happen” (Interview 3 – treasurer at a large corporation). Expressed negatively, we can see that even if the concern for the impact on income is not internalized by the treasurer, there is a risk that it will be imposed
by the accountants: “Finally, I cannot say that accounting decides, but let’s say we will never initiate a transaction without checking on its impact” (Interview 13 – treasurer at a large corporation), and “[…] there are times when budgets are extremely tight, then accounting decides. At least it is the accounting logic that decides. So it is the standard that will drive the decision” (Interview 11 – treasurer at a mid-size corporation). Thus, while the fear of earnings volatility seems to be the motivating factor, there may also be room to maneuver in terms of earnings management.

A sub-category can be distinguished here: firms which experienced significant events in addition to changes in accounting standards. As an example, among our respondents was an industrial company, family-run at first, later absorbed by an American group – and therefore subject to US GAAP – before regaining its independence. Each time the general management and the auditor changed. In this case, the behavior of the treasurer was more influenced by the context than by the standards themselves.

Finally, two other themes emerged from these interviews. The first is that of competencies. Within large groups that are part of the CAC40, accounting, financial communication, or consolidation services seem to be able – with the assistance of Big Four auditors – to provide a technical framework that matches the complexity of the standards. This is even more the case when external expertise is solicited. However, even in such groups, lack of available skills is sometimes singled out as an obstacle. In companies with less structured financial and accounting services, lack of skills is even more critical. This appears to be more organizational than individual. The process for structuring and documenting with respect to hedge accounting qualification involves the whole organization: “IFRSs consider the possibility to hedge future transactions provided that they are highly probable. So one way to demonstrate high probability is a budget supported by realistic historical sales” (Interview 16 – treasurer at a mid-size corporation). In all cases, the treasurer has to rely on an administrative structure on which he or she becomes dependent.

A final aspect seems to be the desire, expressed by several respondents, to change the standards. “So this is a typical example of what we expect for the evolution of IFRS: a move from very quantitative accounting criteria to more qualitative economic criteria in the new version of IFRS 9” (Interview 9 – treasurer at a large corporation). The question is not new: in the USA, under pressure from issuers, regulators replaced SFAS 8 on foreign currency translation with SFAS 52, without ending controversies on the issue (Hoyle et al., 2011). The IASB has also, through amendments of the standards (see, e.g. IASB, 2008), agreed to meet certain requests from practitioners. Through the influence of IFRS, the treasurer became an active participant in the standard setting process through his appropriation of the accounting issues. The postponing of the effective date of IFRS 9 is a proof of the participants’ involvement in lobbying the IASB regarding this issue.

5. Comments and discussion
Similar to Macintosh et al. (2000), in this study we have found that accounting for financial instruments appears to have become a realm of hyperreality in which accounting results seem to become detached from underlying economic reality. Together, we build on Macintosh’s et al. (2000) description of the evolution of the phases of financial accounting, by suggesting in the following paragraph that there is also an evolution of financial instruments and hedging strategies in the direction of greater complexity. In turn, this complexity may generate, in the accounting results, especially under IAS 39, volatility somewhat detached from the one of the underlying asset. The fear of earnings instability among corporate treasurers has caused them to take actions to reduce earnings volatility despite the potentially negative impact on the economic reality as exemplified by cash flow. Based on our interviews, we have identified several types of reactions to the standards.
5.1 Confusion between the real economy and financial accounting

IAS 39 can be understood as a model that can represent different types of economic reality related to financial instruments. Initially, a hedging transaction in an over-the-counter market was intended to reduce the risk of holding a “real asset” (e.g. a bushel of wheat); in other words, the hedge was a type of “insurance” for farmers that was directly linked to the potential volatility in the price of the underlying asset (i.e. the bushel of wheat). This initial stage in the use of derivatives was followed by a “mass production” stage in which the use of hedges and derivatives was commodified thereby allowing the derivatives contracts to be traded in large volumes. The organization and standardization of the derivative markets allowed agricultural derivatives such as futures and options to be traded not only by farmers and cereal products manufacturers, but also by speculators. The large number of monetary settlements before maturity of the contracts for the purpose of settling the transactions indicated that the derivative instruments were being traded independently from the underlying “real assets.” Finally, investors and speculators have been able to combine derivatives to hedge the risk of owning real or financial assets or even the volatility implied by these derivatives (e.g. VIX options and futures). This stage of the use of derivatives can be understood as a type of hyperreality, in which sophisticated instruments hedge derivatives positions rather than real assets. At this stage, “the image is unrelated to any sort of reality: it is its own pure simulacra. […] the image is not that of appearance, it is the one of simulation” (Baudrillard, 1981, p. 17).

These levels of derivative activity can be contemporaneous with one another, resulting in different accounting representations (Macintosh et al., 2000). IAS 39 specifies three possible accounting methods, which can lead to different maps (i.e. accounting results), and thus the shift from one map to another can increase confusion (Houellebecq, 2010). As anticipated by Baudrillard (1981), there is confusion between the map and the territory and this confusion becomes evident in the volatility induced by the accounting model. The fixation on earnings underlined in Interview 14 (see Section 4.1) confirms that the accounting results may have entered a period of hyperreality.

We can interpret our findings from a traditional accounting perspective as well. Our respondents recognized that they give priority to reported accounting earnings numbers rather than following the economic logic of cash management. This finding is similar to the results of Wilner (1982) and can be interpreted as an internalization of a belief in functional fixation. These users apparently are unable to see accounting information in a broader context. They have an “unsophisticated” understanding of the volatility of earnings and equity. In response to this concern, treasurers implement various earnings management strategies. This illustrates the feedback loop between the map and the territory. A treasurer admitted such anticipatory strategies: “Once the impacts are the expected ones, and once the auditors have validated them, we are fully satisfied” (Interview 1, treasurer at a large corporation).

5.2 The fear of earnings volatility

Our findings highlight a fear of earnings volatility which resonates with Baudrillard’s (1981, p. 221) observations: “This panic […] is the one of seeing value dissociated from its content and functioning alone. Values will proliferate and continue to circulate, like the floating capital, or eurodollars, they will spin free of reference marks, completely devalorized but it doesn’t matter: their circulation is sufficient to define a social horizon of value, and the obsessive fear of the ghost value will grow even bigger. Consequently, there is unprecedented terror of value” (our translation). This terror is characterized as an internalization of risk, coupled with an increased consciousness of the volatility. The process is, however, not perceived to be negative but only uncertain because “Implosion is a specific process with incalculable consequences (our translation). Indeed “There is more and more information and less and less sense (our translation)” (Baudrillard, 1981, p. 119) and “Instead of communicating, information wears itself out in the production of communication. Instead
of producing sense, it wears itself out in the production of sense (our translation)” (Baudrillard, 1981, p. 119). Inevitably, this fear also permeates the audit process (Guénin-Paracini et al., 2014) and the tensions in the relationship with the auditor may increase the fear, when paradoxically it was expected to bring comfort. Eventually though, there is a transfer of the control over the accounting reporting decision to the auditor.

Our interviews indicate that the map (accounting results) affects the territory (economic decisions), in the sense that the impact on earnings arising from a modification of the model (accounting standards) affects decision making (the territory). This finding challenges the accountant’s claim to emphasize “substance over form” in that the form is revealed as influencing the substance.

5.3 Adaptive behaviors

Our interviewees share a global consensus about the impact of the IFRS standards on the treasurer’s activity. There is an indisputable unanimity in the perception of an increased workload with respect to both disclosures (Interviews 16, 17) and simulations (Interview 18), both were deemed time-consuming “our work is now dedicated to writing” (Interview 11). In addition, some respondents were convinced that opportunities are being lost through delayed validation (Interview 3). Their temporal horizon is perceived as being modified (Interview 11) and becoming more remote from economic issues. Disoriented by the required compliance with standards, the feeling can be the one of a loss of flexibility (Interviews 11, 16). However, the extra workload requires more connections with operational functions and the treasurer has gained greater visibility within the organization (Interviews 15, 17, 19), i.e. transparency (Interview 38).

Another concern shared by about half of the interviewees is the renunciation of practices not eligible for hedge accounting, which has reduced the numbers of usable instruments (Interviews 18, 19, 31, 45). The goal of reducing volatility is not a treasurer’s decision but originates with the management who wants to simplify the discourse targeted toward shareholders (Interview 45), without simultaneously renouncing profitable opportunities (Interviews 14, 42). The resulting behavior is sometimes described as more prudent (Interview 28). In summary, standards are not only considered to influence strongly the function of treasury management, but also decision making and hedging for foreign exchange risk (Interview 3). However, while treasurers share common views toward the standards, there is no uniformity in their behaviors. Our study revealed four adaptive behaviors, which are similar to those of Rogers (2003). These adaptive behaviors include: “semi-reluctant adopters”, “ubiquitous adopters”, “full adopters” and “indifferent” (see also in Figure 3):

(1) The semi-reluctant adopters avoid complexity by at least partially rejecting any speculative activity in order to concentrate on simple hedging. Volatility avoidance is here synonymous to a better control of earnings. In this category, treasurers comply, yet give up some of their practices, because some of their familiar instruments are not eligible for hedge accounting. Amongst those, one finds variable rates (Interviews 3, 11), foreign exchange swaps, caps, complex derivatives, exotic products, options - especially when combined (Interviews 1, 5, 12, 19, 24, 31, 37, 42, 48). Such instruments were in some cases dedicated to the hedging of recurrent flows emerging from well-known industrial cycles: dividends paid or catalogues revenues are of that kind (Interviews 3, 28, 40). The lack of recognition of those cash flows hampers the ability to hedge prior to their official recognition by the General Meeting of shareholders, for example. What is at stake in those cases is the existence of an underlying asset. Another case is the netting activity of companies working in dozens of countries and currencies which prevents systematic hedging (macro-hedging). Interviewees are depicted as semi-reluctant as they share the sentiment of being constrained, but sometimes admit that it is for their safety (Interviews 11, 12, 14, 32).
The second category of behavior displays a double perspective. In this category, the “ubiquitous[13]” adopter is unsatisfied with the earnings resulting from the application of the accounting standards, and therefore produces a set of two results: one in accordance with the standards and a different one for internal use based on cash results (Interview 5).

The full adopters entirely abide by the new standards; they accept the multi-layers in derivatives markets and their embedded volatility and seize the opportunity for earnings management. This betrays a willingness and capacity to outsmart the model in order to develop a model of the model. Proponents of this category may utilize a business model generating a negative working capital requirement and following a service activity approach rather than an industrial one (Interviews 35, 36, 37). They can even raise the question: “How can we benefit from the regulatory change?” (Interview 37). For the respondents in this category IFRS may provide the occasion to obtain a better understanding of complex products that were poorly or not understood before (Interviews 38, 46).

The indifferent choose not to display a specific representation. This is because they are not accountable to anyone but themselves; therefore, they do not care about their representation to others. This category includes the firms that consider the treasury department as a profit center. They do not fear volatility if this can boost their financial result[14].

Interestingly, our findings suggest that in the same environment, agents or organizations may be able to define which type of representation they want to present in their financial statements and accordingly, produce the corresponding image or images. We also observed significant differences in the viewpoints of the participants. These viewpoints are far from stable, in that the appropriation of the accounting standards is a learning process where individuals and organizations are likely to evolve from defensive (avoidance) to more offensive (opportunistic) attitudes, some former semi-reluctant have later become full adopters. Over time the understanding of the standards tends to be more subtle with a dynamic dialectic between the map and the territory. Hyperreality may then become a new social reality. The main challenge for managers remains in identifying the discretionary space offered by the new standards, where room for maneuver is likely to bring opportunities for earnings management.
Thus, we extend Macintosh et al. (2000) when showing how the confusion brought about by maps, hitherto limited to financial reports and analysts, may penetrate into the organization. In this sense, we contribute to the clarification of the socio-economic debate on the hypothesized link between standard setting and financial crises. We tend to see here the elements of hyperreality as collective representations carried by managers who internalize the map. Driven by their fear of earnings volatility, treasurers tend to adopt defensive attitudes, and only later develop more subtle behaviors.

The question is no longer about whether accounting—through its major concepts, like income and capital, represents social reality or not, but to understand how managers (here treasurers) in their re-interpretation of “accounting numbers” tend to create their own representations. Income and capital tend to replace performance and economic value, and achieve the status of totems in treasurers’ mindsets. Moreover, shifts in accounting standards-setting have concrete effects—at least temporarily—on actual practices. Thus, if numerous treasurers simultaneously adopt an avoidance strategy toward speculative instruments this could actually cause a downturn in the value of such instruments.

In July 2014, the IASB issued an amended version of IFRS 9 with a “substantially reformed approach to hedge accounting.” In their justification of this amendment, the standard setters acknowledge: “During the financial crisis, the delayed recognition of credit losses on loans (and other financial instruments) was identified as a weakness in existing accounting standards.” Hence, the IASB admits to some perverse effects arising from the IAS 39 and the IFRS 9 projects. The decision is a proof of the impact of lobbying (Noël et al., 2010). The arguments of circularity and the fear of volatility probably played a role here. One might also expect greater articulation between the map and the territory. For instance, it might be interesting to observe the behavior of the avoidance category. Also worthy of attention would be the observation of the pace of early adoption for the revised IFRS 9.

6. Conclusion

Our research question focused on the impact of accounting standards on treasurers’ hedging decisions. Toward that aim, we conducted a qualitative research project involving 48 semi-structured interviews. Our findings confirm the impact, both on the activity of the treasurer and on his/her relationships with professionals in the area of finance, control, and auditing. Furthermore, the interviews confirm the phenomenon described by Baudrillard, that of confusion between the map (the accounting results) and the territory (the economic decisions).

The interviewees pointed to fear of increased earnings volatility and excessive complexity of the regulation as sources of confusion. This is consistent with the literature on similar changes in the US environment (Evans et al., 1978; Wilner, 1982; Zhang, 2009). Our observation of the actual process (Van De Ven, 1992) provides a double contribution. First, our approach focuses on perceptions and practices rather than the variables that are studied through statistical analysis and experiments. On the other hand, we complement early works to highlight the complexity of the economic decisions. The behavior of corporate treasurers is multiple and is not a static variable. We have seen that in face of the fear of volatility, which is perceived as a real problem by most treasurers, attitudes are not homogenous. The outcomes are often the result of negotiation, compromise, or trial and error, a process in which the treasurer is one actor among others. We have represented this dialectic using a scheme that links the territory to the map via modeling through the standards, and where the map influences the territory.

We also have shown that the accounting results have a totem status. There is a paradox, in the sense that the new standards were presented as being based on a “cash culture.” In our case, treasurers focus on accounting results despite their activity which is supposed to focus on cash flows. As we have seen, this may be the consequence of functional fixation toward accounting information which leads to information inductance among treasurers. Standard setters ought to pay attention to such potential effects. Even if the IASB does not
insist on the use of IFRS other than for users of financial statements, they should acknowledge the fear of earnings volatility, especially through an increased use of OCI as an alternative to net income. As mentioned above, the OCI figure is an intermediary, but also an ambiguous sign. According to Macintosh et al. (2000), through OCI “in Baudrillardian terms, the difference between income and capital implodes” (p. 37).

Our findings also led us to more unexpected observations. From a broader perspective, we observed the influence of financial statements on economic decisions in general. While creating new standards, standard setters tend to create a world where substance and form are more and more intertwined. Adaptation to this new world requires a learning process. Hence, there may be a new paradigm of use of accounting information; not by users, but also by managers.

The type of qualitative research undertaken in this study has its limitations. It cannot be demonstrated that our findings are universally generalizable. There is a contextual specificity to the treasurer’s function, which reinforces a particular focus on accounting results. The CFO is simultaneously the superior of the treasurer and responsible for financial reporting, and consequently subject to a conflict of interest that does not necessarily apply to other managerial levels. Therefore, our findings cannot apply to all managerial functions.

We have taken an exploratory perspective in this paper, “without an a priori,” but perhaps we could also have referred to the sociology of translation (Akrich et al., 2006). Another potential axis would be to extend the interviews to the auditors, a professional group that plays a key role. As mentioned above the adoption of the new version of IFRS 9 may also generate behavioral change and learning. This is perhaps the main limitation of our research: the process of formulating applicable standards is on-going. At the same time, this leads to great potential for extending the study. As an example, a study of actual volatility in connection with earnings management would be another approach, difficult to implement but promising.

Notes
1. This thesis, disseminated in political circles where accounting standards are accused of inflaming financial crises, has been expressed in the following way: “One sees this future devaluation in accounting policies that value assets at market prices, which change constantly with the whim of the market. When euphoria reigned over the markets, balance sheets were revalued upwards and the revaluation in its turn boosted equity prices. When fear took over, balance sheets were written down and this devaluation in its turn reduced equity prices. […] To understand how absurd this accounting effect is, it is sufficient to recognize that with the market value system, a company in difficulty can record an accounting profit simply due to the fact that the deterioration in its reputation reduces the market value of its debt!” This is not the stance of a critical accounting theorist who dislikes the concept of fair value but that of the former French president, Nicolas Sarkozy, in his speech at the 40th World Economic Forum in Davos, January 27, 2010. Gaynor et al. (2011) empirically confirmed such a potential perverse effect of liabilities measured by fair values.
3. See for example, November et al. (2010).
4. The issue has also led to discussions within the IASB (ITAC 2008, IASB 2008, Fiechter, 2011).
5. Information inductance implies that managers may make economic decisions based on the accounting impact rather than the economic impact.
6. The mandatory adoption of IFRS 9 began on January 1, 2013. In November 2012, the IASB issued a new Exposure Draft on the matter (IASB, 2012), open to comments until March 28, 2013. It proposed “limited amendments” to IFRS 9 and the deadline for implementation was postponed, until January 1, 2015. In July 2014, the decision was made to postpone once more to January 1, 2018, with “early application permitted”. See www.ifrs.org/Alerts/PressRelease/Pages/IASB-completes-reform-of-financial-instruments-accounting-July-2014.aspx
7. These are only non-financial institutions because treasurers working in the banking and insurance sectors have their own association called the AFTB (Association Française des Trésoriers de Banque). This is in line with the literature which tends to study these sectors separately.

8. Amongst the 52 treasurers who agreed to meet the researchers all but two had worked used the new IFRS standard while two others were working in corporations using the French standards only. These interviews were excluded from the panel.

9. We find very similar proportions in the sample of 211 answers to the questionnaire.

10. This is probably the case because the share of corporations belonging to the CAC40 is significantly higher in the smaller panel of interviews.

11. In this part of the paper, we extracted quotations from 16 interviews among the 48 carried out. They are the most representative ones. These interviews have been ranked from 1 to 16.

12. The behavior of managers (in our case corporate treasurers) is not a static variable. It evolves over time in a process that is changing due to collective learning. Therefore, it would be misleading to provide any frequency of observation of each category. It is also important to mention that these categories are not exclusive: one treasurer might belong to several categories, especially when he/she passes from one to another.

13. Ubiquitous refers to users who are able and willing to be present in more than one place at the same time, in our case, willing to project more than one image.

14. In our sample, these firms account for 6 percent of the total. This seems in line with other samples. For instance, Stulz (1996) reports that 7 percent of the firms in the USA consider the treasury department as a profit center. Also, in a survey made by e-mail in 2010, the French Association of Corporate Treasurer found 9 percent for the French firms.

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Further reading


Appendix 1. The interview guide
Question 1: in our questionnaire distributed to corporate treasurers, slightly more than half stated that developments in international financial reporting standards influence their hedging behavior. What do you think? More generally, do you think that international financial reporting standards have changed the treasurer’s job?
Follow-up questions:
1a. In either case, have you personally been influenced or not?
1b. Can you give us examples that you have witnessed or in which you have taken part?
1c. In what circumstances do you foresee an influence?
1d. Outside IFRS as such, are there any other recent developments that could have affected the behavior of managers?

Question 2: in your view, has the introduction of new standards altered responsibilities and/or working practices within your management structure?
Follow-up questions:
2a. Please provide details.
2b. In which areas exactly (e.g. report formats, control systems, bonuses, evaluation)?
2c. It appears that new standards have not changed your role at all – is that correct?
2d. In your view, have these developments been mainly positive? Were new standards a necessary part of the process or could these developments have taken place without new standards?

Question 3: with regard to your organization, who – internally and externally – has been instrumental in the introduction of new standards?
Follow-up questions:
3b. Have some of these bodies explicitly required you to change your behavior?
3c. It appears that it has been left to you to interpret new standards – is that correct?
3d. Do you feel the need to be better supported, for example, by additional training?

Appendix 2

| ADP | Carrefour | Pernod-Ricard |
| Air France | Cegid | Petzl |
| Air Liquide | Comap | PPR (Kering) |
| Akka | Danone | Rossignol |
| Alcatel-Lucent | Dassault-Aviation | Saint-Gobain |
| Alstom | EDF | Safran |
| Alten | Eramet | Sanofi |
| Angst-Pfister | GDF-Suez (Engie) | SEB |
| ArcelorMittal | Hermès | Sodexo |
| Arc-International | JC-Decaux | Soitec |
| Ariane-espace | L’Occitane | Somfy |
| Auchan | L’Oréal | STMicroelectronics |
| Bic | Mersen | Tarkett |
| Biomérieux | Norbert-Dentressangle | Total |
| Boiron | Orange-France Telecom | Ubisoft |
| Bourbon | | Veolia Environnement |

Table AI. List of company treasurers interviewed

Note: Specialized auditors from Deloitte, Ernst & Young and KPMG were also met

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The early evolution of corporate control and auditing: the English East India Company (1600-1640)

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Abstract

Purpose – The purpose of this paper is to explain the origins and evolution of auditing and control by linking the changes in the manner in which the audits were conducted with the changes in the institutional function and development of the English East India Company (EIC).

Design/methodology/approach – Using Sunder’s contract theory of a firm as an interpretive framework, this paper introduces to the debate material documenting the evolution of the auditing practice during a period of 40 years using the single case of the EIC.

Findings – Auditing in the EIC evolved from a simple adjudication on allowable expenditures to ex post verification of transactions, and from using volunteers to paid auditors. Initially, the company was organized into a series of separate, terminable stocks, and simple verification by volunteer auditors chosen from among the shareholders was sufficient to secure the latter’s interests. When the increasing number, size, and complexity of transactions by the EIC rendered the adjudication approach insufficient, ex post verification of financial transactions was added. With a clearer separation between ownership and control at the time of the introduction of permanent joint stock, the audit function assumed a more professional form.

Originality/value – This paper contributes to the research on the early modern period at a time of the formation and rapid development of the first joint-stock organization. It offers a dynamic picture of the evolution of control and auditing as a response to the growth of business, organizations, and the attendant challenges of governance.

Keywords Governance, Accounting history, Auditing, Corporate control, East India Company

Introduction

Accounting and auditing practice has evolved through path-dependent historical processes over thousands of years (Waymire and Basu, 2008) and has always been an integral part of governance, accountability, sustainability, and other controlling and monitoring processes or regimes (Hopwood, 1983; Cushing, 1989; Miller and Napier, 1993; Toms, 2005; Funnell and Robertson, 2011; Carnegie, 2014; Toms and Fleishman, 2015). Historical studies of the change in accounting and auditing practice are important to better understand how and why accounting and auditing “got where it is today” (Zeff, 2003, p. 189). The research of auditing history examines various early forms of audit, such as manorial, the oral form, and later fraud prevention, using the available archives. However, our knowledge of how accounting and auditing practice evolved still remains limited.

This paper seeks an understanding of the role of auditing and the evolution of its institutional structure and scope within the English East India Company (EIC). A contextual analysis of surviving business records from the first 40 years of the EIC reveals a fascinating historical backdrop for analyzing various organizational forms and their corresponding accounting and auditing systems. This paper fills a void in the literature by providing more insight into the evolution of auditing as a result of experience, continuous adjustments in the company’s governance, and efforts to secure better management of its resources given the difficulty of direct monitoring in distant locales. The paper suggests that auditing in the EIC changed with the number, size, and complexity of transactions. It evolved from a simple adjudication on the allowable expenditures to ex post verification of transactions, and from using volunteer shareholders to paid auditors-shareholders to do the
audit work. However, in the later part of its first 40 years, the company switched to hiring full-time auditors who did not have to be shareholders.

This paper makes at least three important contributions. First, the EIC, especially in its later decades, received the attention of many business and accounting historians from a variety of perspectives (Scott, 1912; Chaudhuri, 1965; Anderson et al., 1983; Keay, 1991; Jones and Ville, 1996; Hejeebu, 2005; Erikson and Bearman, 2006; Robins, 2012; Sivramkrishna, 2014). In particular, several studies have analyzed the accounting and reporting practices of the EIC (e.g. Scott, 1912; Chaudhuri, 1965; Baladouni, 1983, 1986; Bryer, 2000). These authors have discussed the importance of audit for the overall success of the organization during its first 40 years and have referred to the importance of EIC auditors as investor representatives. However, the nature of the audit work and the changes in the auditing practice of the EIC were not included in these analyses. Based on an analysis of surviving business records available in the British Library and secondary sources, this paper provides insights into the emergence and evolution of auditing and shows that the change arose from the needs of the participants and the organization’s governance. It therefore contributes to the research on the “history of accounting” (Napier, 2009, p. 30). However, the paper offers a broader understanding of how and why auditing evolved in the context of the company’s organizational structure and governance.

Second, this paper extends the research on the early modern period, which was identified by Power (1997), Napier (1998), Mennicken (2008), and Maltby (2009) as having a major gap in the knowledge about the development of auditing. This paper examines the single historical case of the EIC to provide a remarkable example of how auditing practice arose and developed. Thus, this paper adds new insights into the evolution of auditing and control from a simple adjudication on allowable spending to the ex post verification of financial transactions. In this case, the study of the emergence of auditors and auditor independence, from volunteer shareholders through compensated shareholders to outside professionals, may help us better comprehend the origin of auditing.

Third, this paper contributes to the literature by using the Sunder's framework to interpret the emergence and shaping of auditing and control in the early years of the EIC. In its earliest few years, the EIC adopted an elementary form of accounting used for proprietorships, not because it was best suited to an organization with hundreds of owners but because it was the best-known form of accounting. Understandably, this form was found wanting, and this paper explains why new methods had to be devised to address the problems that arose.

Surviving documents from the earliest years of the EIC, on which this study relies, elucidate the function and evolution of this firm’s auditing practices. These voluminous sources, available in the Oriental and India Office Collections of the British Library in London, include A Calendar of the Court Minutes of the East India Company; diverse versions of the Calendars of State Papers, Colonial Series; The Register of Letters &C. of the Governor and Company of Merchants of London Trading into the East Indies; and The Laws or Standing Orders of the East India Company. These documents have been compiled into a collection of original records that has been edited and arranged in a chronological order by G. Birdwood, W. Foster (1906-1927), W.N. Sainsbury, and E.B. Sainsbury. In this compilation, several original documents, such as the Register of Letters and Calendars of the Court Minutes, are reprinted in full, with only summaries of other documents, such as the Calendars of State Papers. Together, these documents constitute a rich collection of primary materials for this inquiry.

The first step in analyzing these materials was to find evidence of events that reveal auditing practice in the EIC to identify and reconstruct the relevant episodes. The next step was to identify how these episodes were linked to the governance problems. In the third step, we examined “constellations” (Burchell et al., 1985 pp. 399-400; Miller and Napier, 1993; Napier, 2009, p. 42) – particular relations which exist between existing practices, processes, and institutions, to understand changes in the audit practice as attempts to solve
the problems of the company’s governance and organizational structure. Finally, the contract theory was used as a framework to help understand and interpret these events. Data from secondary sources were used to triangulate and validate the findings.

The analysis covers the first four decades of the company (1600-1640). Chaudhuri (1965) characterizes this period as the company’s “early stage,” and Keay (1991, p. 1) describes it as a period of “quiet trade,” a time when the EIC was a simple commercial venture engaged solely in trade before changing its strategy and acquiring administrative and military power. The period is fascinating for studying the emergence of auditing and control for two reasons: it was a time of rapid growth for the company and it devised many organizational innovations to adjust to the changes in its operations and environment. Audit and control had to be modified to meet the needs of the company and its shareholders.

The study commences with a literature review on auditing in a historical context, then discusses the interpretive framework on the basis of Sunder’s contract theory of the firm, and subsequently presents the EIC and its embedded monitoring problem. Archival and other evidence is then used to examine the evolution of auditing at the EIC. The earliest and most likely oral form of the role of auditors and auditing procedures is presented first, and is followed by the presentation of the role of auditors and auditing prescribed by the Standing Orders of the EIC – the regulations governing the organization, operations, and accepted practices from 1600 to 1620 and then the examination of the evolution of audit-related concepts and practices from 1620 to 1640 to address the agency problems that arose.

The last section summarizes the findings and presents the conclusions.

Prior studies on auditing history
Maltby (2009) surveys the wealth of research on the emergence of auditing and audit history in the early modern period. Accounting and auditing historians have addressed issues such as the reasons for undergoing an audit, the relationship between audit and corporate governance, and audit objectives and techniques. Although modern auditing is sometimes said to have originated in the middle of the nineteenth century, many scholars (e.g. Edwards, 1989; Power, 1997; Napier, 1998; Maltby, 2009) have observed that auditors existed much earlier[1]. Watts and Zimmerman (1983) document the performance of audits by various forms of early business corporations, such as merchant guilds, merchant adventurers, and regulated companies, and suggest that auditing arose as a solution to the problem created by the separation of ownership and control explained in detail in agency theory. The auditor provides assurance concerning management stewardship of the resources entrusted by shareholders and validates the provision of reliable information by management to principals for the purpose of supporting decision-making and performance assessment. Other scholars offer alternative views for the reasons firms undergo an audit in an unregulated environment, including avoiding the threat of regulation (Edwards, 1985), the possibility of shifting some risk of financial loss from litigation by the managers to the auditors (Wallace, 1980), and raising private capital (Esplin et al., 2015).

The accounting and auditing literature also presents audit histories that address the role of auditing in governance structures (Bryer, 2000; Toms, 2002; Rodrigues et al., 2009). Audit is usually portrayed as a means to discipline directors. For instance, in his examination of accounting for “capital,” Bryer (2000) briefly discusses the role of auditors in this process and refers to the importance of EIC auditors as representatives of the investors. In his view, audit is an aspect of the seizure of power because investors believed that they would have access to better and more reliable information than that volunteered by the EIC’s directors. Similarly, in the case of the Oldham district limited companies that operated 250 years after the EIC – Toms (2002) documents the change in the nature of controls with the arrival of a new owner. In this case, financial controls replaced auditing because such controls were likely viewed as a more efficient solution in the governance arrangement. Rodrigues et al. (2009)
discuss the use of audits as a governance mechanism in eighteenth-century Portugal. Edwards (2001) and Walker (2004) discuss the developments in accounting professions from a historical perspective and suggest the introduction of the auditor in an unregulated economy changed a simple agency relationship to a three-sided one, thus creating the new problem of auditor independence.

A sparse but growing number of studies provide some understanding of the objectives and techniques of an audit, particularly before the nineteenth century. The medieval accounting and auditing history research often refers to the audit as an internal control mechanism. For instance, manorial auditor work and techniques have been documented by Oschinsky (1971), Harvey (1994), Power (1997), and Jones (2008)[2]. Brown (1962, p. 696) provides an analysis of the changes in auditing objectives and techniques. He suggests that in medieval Europe, the primary goal was to use control mechanisms (including the use of two scribes) that could prevent defalcations within the treasuries of the rulers, and the secondary goal was to minimize errors. With the rise of the Italian city-states, the objectives of auditing changed, and the practice came to be observed as a means of assisting in the verification of the accountability of the captains who were returning from adventures. In that sense, auditing came to have a fraud-prevention function. Auditing and fraud detection in the nineteenth century have attracted considerable attention among researchers (Humphrey et al., 1992; Hooper et al., 1993; Chandler and Edwards, 1996; Chandler, 1997; for a summary, see Maltby, 2009, p. 233).

Many researchers suggest the need to enhance the understanding of accounting as a social and technical practice and the dynamics of the changes in accounting (Hopwood and Miller, 1994; Carnegie and Napier, 1996; Toms, 2005; Gomes, 2008; Carnegie and Napier, 2012; Robertson and Funnell, 2012). Mennicken (2008) emphasizes the need to understand the process of change within auditing. By accepting the possibility of historical change, we also recognize that the possibility of the continual evolution of accounting and auditing systems makes it difficult to obtain more than a fragmentary picture of the past (Hopwood, 1987).

**Interpretive framework**

This paper offers more than a simple agency perspective. In particular, this study examines the development of auditing through the lens of the contract theory of the firm (Sunder, 1997). Contract theory is particularly suitable for the interpretation of the collected material as it allows us to link the organizational functions to the development of auditing in the EIC. Contract theory is not an example of the agency model; it is rooted in the Rousseau’s social contract theory and develops Chester Bernard and Herbert Simon’s theory of the firm and organizations to understand a broad range of accounting phenomena. Contract theory considers the interests of all participants of the organization, as they enter into a “social” contract to make their contributions in exchange for their share entitlements. This theory recognizes that any change in the contractual arrangement of any participant influences all other members of the organization.

Through this theory, a firm or an organization is viewed as a set of contracts among rational economic agents. Agents are rational in the sense that within the limitations of their opportunities and information, they choose better courses of action over less desirable ones. Contracts may be explicit or implicit, short term or long term. By entering into these contracts, the agents agree to deliver resources to the organization’s pool. Participating agents are promised remuneration in exchange for their contributions. An agent agrees to enter into a contract if the expected payoff is worth the investment.

In the contract model of the firm, accounting helps control resource flows by assembling, implementing, enforcing, modifying, and maintaining organizational contracts. It helps implement and enforce the contracts that constitute the firm. Accounting is part of the set of contracts because it measures, records, and reports the contributions of the agents and
compares them against their contractual obligations, and because it measures and records the entitlements of the various agents. It also plays the important role of helping maintain a liquid market for contractual slots and for factors of production supplied by their occupants to ensure that the termination and resignation of some agents do not disrupt the operations and existence of the whole firm. In this theory, accounting provides a pool of common knowledge of verified information to all participants to facilitate negotiation and contract information.

In the contract theory, auditing helps mitigate certain costs that arise from the conflicts of interest among the organization’s participants. The economic role of auditing is to reduce agency costs. Individuals’ limitations leave open the possibility that the “information” shared by the individuals is incomplete or even incorrect (Sunder, 1997, p. 115). Auditing, therefore, monitors the quality of information provided by those who possess superior knowledge to other participants in an organization.

Sunder discusses two hurdles when engaging an auditor. An auditor is engaged when agency costs become large given the difficulties of direct mutual monitoring related to, for example, the shareholder-manager, the borrower-lender, or corporate divisional agencies. However, introducing a third agent modifies the relationships within a firm. As Sunder explained:

The second problem is that the introduction of a third agent into a two-person agency not only changes the relationship between the two agents but also gives rise to new relationships and the associated agency costs that did not exist before. In a shareholder-auditor-manager system, the shareholder does not know what the auditor actually discovered or how diligent the investigation and preparation of the audit report were. Everything is possible: a cursory audit, less than truthful reporting, and auditor-manager collusion (Sunder, 1997, p. 115).

The shareholders will consider an audit important only in a situation where they believe that the expected losses from being a third agent in the shareholder-auditor-manager relationship, plus the audit fees, are less than the expected benefits of the audit report. Sunder (1997, p. 115) suggests that in such a setting, both managers and auditors have an information advantage over the shareholders, managers have an information advantage over the auditors, and auditors have the advantage of their accounting expertise. This three-agent contract set must yield better prospects for all three participants compared to what each of them could obtain alone by forming smaller coalitions.

Auditors provide services to the firm in exchange for their own entitlement. In the modern audit arrangement, the entitlement is an audit fee. However, in past arrangements, an auditor received other entitlements. As rational agents, the auditors seek their own goals through their participation in the organization in exchange for their services. According to Sunder (1997, p. 113), as with accounting, the auditors play an important role in defining, operating, and enforcing the contract set of the firm. However, unlike the case of other participants in a firm, auditor contributions do not enter the production function. These contributions are only needed when the organization takes specific forms. Therefore, the function and scope of the audit may differ significantly among organizations.

Different accounting systems are appropriate for different organizational forms. Organizations change in size and form over time, as does the environment in which they operate. Sunder (1999) analyses the development of accounting by examining several major organizational forms. As proprietorships grow to include one or more levels of hired managers, bookkeeping is supplemented by the elements of stewardship accounting. If ownership becomes dispersed among a large number of shareholders, the stewardship model must be supplemented by a full-fledged system of financial reporting.

In smaller organizations in which a clear division between ownership and control is not necessary, accounting processes record resource flows and establish the cause-and-effect relationships between the costs and benefits of each transaction. Individuals’ business activities are simple enough to require only basic accounting in the form of classical
bookkeeping, and auditing may be used for operational control. However, as business activity grows in complexity and the organization adds layers to manage this growth, simple bookkeeping must be replaced by the stewardship form of accounting. The problem of different organizational members possessing different information that they do not necessarily wish to share becomes more critical. Private interests motivate members to use their information to their own advantage, which may diverge from the interests of the others. Each participant in the organization has personal motives and different information; therefore, operational control calls for the assessment of managers who direct the flow of resources. However, managers’ contributions to the organization are largely intangible and difficult to observe. This difficulty triggers the development of auditing in the contemporary sense of this term. The most advanced third form – financial accounting – emerges when equity capital is raised from a large number of shareholders who cannot be in direct contact with the operations of the business or its managers. Shareholders in large organizations do not actively participate in managing them, so they are vulnerable to the misuse of their resource contributions. An arrangement is needed to ensure that every participant in an organization is delivering the expected contributions.

Before turning to archival analysis to examine the emergence of auditing and the changes in its functioning in the early years of the EIC, we introduce briefly the company, its organization, its governance, and its business structure as well as its governance in the first 40 years of its existence.

**Historical context: organization and business environment of the EIC**

On September 22, 1599, 101 merchants and gentry from London, including 23 members of the Levant Company, agreed to provide the capital to mount a voyage to the East Indies. On September 25, this group petitioned the Privy Council of England for a charter of incorporation. A royal charter was issued on December 31, 1600 that incorporated 218 persons as the governors and company of merchants of London for trade in the East Indies. This group was granted a 15-year renewable monopoly on all English trade to the east of the Cape of Good Hope. Queen Elizabeth I granted the company an exemption from outward customs for their first four voyages and permission to re-export up to £30,000 in bullion in any single voyage[3]. These privileges were renewed and expanded by subsequent royal decrees, typically after prolonged and difficult negotiations with the English Crown (Irwin, 1991).

At first, the EIC traded and purchased commodities in India in any port that offered the facilities (Chaudhuri, 1965, p. 15). The company awaited the return of its ships from one voyage before preparing for the next. In the company’s early years, its shareholders traded separate and terminable stock and behaved like investors in a regulated company, committing money to a single voyage until its completion before committing to any future investments. In 1607, after the EIC’s third trading voyage, high realized returns encouraged increases in the scale of investments and prompted a decision to send annual trading voyages to India, each of which set sail before the preceding voyage had been completed and its results were known (Scott, 1912, p. 155; Chaudhuri, 1965, p. 208). After ten years of experience in trading in coastal cities, the company had acquired sufficient expertise and was prepared to commence trading with India’s remote regions (Steensgaard, 1974, p. 170).

In 1614, 14 years after its establishment, the EIC evolved into a more advanced organizational form with a new strategy and structure. In particular, the company realized that efficient trade required local operations (trading posts or factories – a place for factors to do their trading) to be established in foreign locales. EIC voyages transported factors who stayed in India to develop future trading opportunities and prospects. The factors sold the company’s goods from inventory and bought and stored the return cargo. Having goods ready for loading when the ships arrived from England shortened the turnaround time...
It also avoided the higher costs of buying goods in a seller’s market after a ship arrived at a port (instead of buying them when prices were low, especially for cyclical commodities). By 1615, the EIC had opened factories in India, Thailand, and Indonesia. At approximately the same time, the company began to engage in the intra-Asian trade of Indian textiles.

In its first five decades, the EIC had a simple economic structure rooted in a body of shareholders called the general court. One of the most important powers of this court was to annually elect the governor, the deputy governor, and 24 persons known as “committees” (Birdwood, 1886, p. 168). These individuals may be described as the executive branch of the company, called the Court of Committees, because they were entrusted with the daily conduct of the company’s affairs. In modern terms, these committees were described as shareholder managers. Later, the term “committees” was replaced by “directors.”

In the first few years of the EIC’s history, the general court met as needed, which could be several times a week. Between meetings of the general court, the governor and committees of the company attended smaller meetings to discuss immediate business and operational concerns. The minutes of the general court and the court of committees reveal that these discussions frequently revolved around victuals and merchandise that was purchased and/or payments for purchases and services that were rendered to the EIC (e.g. Birdwood, 1893, pp. 98-101).

The standing orders issued in 1621 established a rule that the meetings of the general court were to be held at quarterly intervals and were to be devoted to shareholder discussions of EIC business. The issues discussed at these meetings included the firm’s financial situation, external relationships, and voyages. The frequency of the general court’s meetings was again reduced in the 1640s to twice a year, in April and September. Until 1657, all of the company’s shareholders were entitled to attend and vote at the general court, and each shareholder had one vote regardless of the amount he had invested in the firm. Subsequently, this strict equality of votes was replaced by a step function in which 500 shares were equivalent to a single vote (Harris, 2005).

The court of committees met frequently to maintain tight control over the company’s affairs. To manage these concerns and other operational aspects of the EIC’s business, the court appointed small groups of EIC members to committees, which differed from the committees included in the court of committees. Paid employees were eventually hired to assist these members. After 1621, these committees assumed a less transitory and more permanent character. In fact, these committees were regularly identified in the court minutes as being responsible for the accounts, lawsuits, private trade, treasury duties, letter writing, and other functions.

It is worth noting that there was no accountability to shareholders in the EIC’s continental cousin, the Dutch East India Company (VOC). While the EIC was a private company organized by private investors, the VOC was created from the merger of several companies that traded in the East Indies in 1602 and had a substantial social purpose (de Jongh, 2011). The organizational structure of the VOC also differed from that of the EIC. The VOC was composed of six departments, known as kamers or chambers, one for each city or region whose trading company (voorcompagnie) was part of the merger (Robertson and Funnell, 2012, p. 349). Individuals interested in participating in the VOC could do so only by paying capital to one of the directors. Each chamber delegated several of its directors to attend the regular meetings of the 17 executive committees, which were held in Amsterdam. Although EIC shareholders enjoyed a stronger voice, VOC shareholders had better exit opportunities (Hirschman, 1970). These exit possibilities were most likely considered by the promoters of the VOC to be sufficient for disciplining the company’s management. These differences in governance and organization of the EIC and VOC underlie the differences in the development of their accounting and auditing practices.
The VOC was not required to publish financial statements. Shareholders had only the promise of a full accounting report after ten or 20 years of the VOC’s existence. However, the charter did set rules for intra-company accounts, or transfers between the chambers. In fact, an audit was never performed, and the accounts had not been made public 10 or even 20 years after the VOC’s incorporation. In 1622, the VOC’s directors proposed extending the charter by 50 years without accounting for their performance for the preceding two decades (de Jongh, 2011; Gelderblom et al., 2011).

The VOC did not use auditing. By contrast, the auditors were important in the governance of the EIC, especially during its first 40 years. Later, the EIC became more of a political organization than a business, and the active role of auditing in its governance gradually declined. The following three sections explain how the auditing in the EIC evolved from a simple adjudication on allowable expenditures to the ex post verification of transactions.

Voyage accounting and auditing as a straightforward verification of transactions
According to the Sunder’s theory of the firm, in smaller organizations where a clear division between ownership and control is not necessary, accounting processes record resource flows and establish the cause-and-effect relationships between the costs and benefits of each transaction. A simple form of classical bookkeeping is sufficient for them. However, the proprietors face the fundamental problem of willingness to share knowledge among the organization’s members, and the need for auditing emerges as a simple operational control mechanism.

Originally, the EIC was a hybrid of a joint-stock company and a regulated company. Voyages were organized as a series of separate, terminable stocks. At the termination of the contract, investors received entitlements in the form of capital subscribed, “freedoms” to the voyage[6], and a portion of the profits in the form of divisions. A simple “voyage” accounting system sufficed. Each subscription-voyage was a firm founded at the beginning of the voyage and liquidated at its end, at which time all of the net proceeds from the voyage were divided among the shareholders on the basis of their subscriptions. When proceeds became available before liquidation, they were also divided pro rata and distributed to the “adventurers[7].” Classical bookkeeping proved insufficient for EIC in the absence of a single proprietor.

When the company organized single voyages without permanent salaried staff, business was conducted by its designated shareholders. Various shareholders were involved in purchasing victuals and commodities and in doing any other work required to allow the first EIC ship to set sail for India. Thus, the problem from the proprietor’s viewpoint was that different organizational members possessing different information might not necessarily share their information. Since each participant in the organization had personal motives and different information, operational control called for the assessment of participants in the organization who directed the flow of resources. A control mechanism was needed to ensure that every participant in an organization delivered the expected contributions, thus resulting in the need for auditing.

Not surprisingly, the terms “audit” and “auditor” are found in the records from the EIC’s inception. In the first years of the EIC, as the contract theory suggests, the audit was viewed more as an internal control mechanism to assess the participants involved in the flow of the company’s resources. In that sense, the early-stage audit in the EIC resembled the manorial audit described in the medieval accounting literature (Oschinsky, 1971; Jones, 2008). A shareholder designated to make purchases financed them with his own funds and requested reimbursement from the EIC, which was disbursed only after auditors verified the validity and accuracy of the invoices. These auditors, who were appointed on an ad hoc basis, accepted the passive role of legal witnesses to transactions and played a more active role in examining documents, confirming the accuracy of all disbursements, and certifying that
company documents were not suspicious. The minutes of the court of committees reveal many such examples (e.g. The Calendar of State Papers, Colonial Series, East Indies, China, and Japan, 1513-1616, pp. 148, 151, 154-157, 160, 171, 273). We illustrate a few here:

(1) To verify the accuracy of the company’s records:

Mr Alder Watters Mr Cordell Mr Wyseman Mr Howe and Mr Harryson or any 3. Of them are appointed Auditors to receive the Accounts of the Purchasers and to examine the same and as they find the said accounts to stand to certify their opinions to the Committees to find if anything fall out in the same accounts worth the consideration of the said Committees (the) ordered may be taken therein by them (The 16th of December, 1600) (Birdwood, 1886, p. 99).

(2) To verify the validity and accuracy of an invoice:

Warrant is given to Mr Ald Bannyng to pay to John Gover, for viij hh[8]. of Aquavite cntg 482 gallons (of Aquavitea) the some of ninty six pounds viij at iiij the gallon /in full payment.

It is ordered that the Treasurer accounts shall be passed with all expedition and to see what money have been paid in by the adventurers and what remains in their hands. To find that is their to want of money which cannot be otherwise supplied then by the increase of the general adventure, that then the generality may be called together and their is appointed for Auditors. Mr Cordell mr Style. Mr Wyseman. Mr Harrison (The 31st of December, 1600) (Birdwood, 1886, p. 107).

(3) To verify the accuracy of disbursements:

Order is given to Alden Hollyday to pay unto Henry Ryvelle Coop for Caske in full payment of him accounts audited by Mr Chambers and Mr Harryson the some of threescore and one pounds.

The like order is given him to pay unto Jon Hardway Coop for Caske in full payment of his account audited and allowed by Mr Wm Chambers and Mr Wm. Harryson the some of fifty and seven pounds fifteen shillings [...].

It is agreed that mr Cordell mr Wyche and mr Bell shall proceed in the auditing of the Pursers accounts and all other accounts related to the red dragon (17th of February, 1600) (Birdwood, 1886, pp. 146-147).

As observed from these examples, three to five shareholders, called auditors, were typically appointed to receive and examine the accounts of various purchasers. These auditors were supposed to work together or “any three of them” in the event that certain auditors were unable to be present at a particular time. The auditors not only verified account balances but they were also expected to express an opinion if they found anything in the transactions that warranted additional consideration by the court of committees. This expectation by the company for the auditors to be present at the court meetings and to present their findings suggests that the report had an oral form. The primary sources do not provide direct evidence that the auditor’s report was read out to the court in the early years of the company. At the same time, the minutes of the court of committee and the general court reveal numerous examples of auditors being present at the meetings and reporting their findings to the courts.

In the EIC’s first years, the auditors were drawn from the court of committees and were present at meetings in which they were appointed. They reported to the court of committees and although they were not always the members of the court of committees, their presence at its meetings indicated their personal and direct involvement and interest in running the company’s daily operations. This arrangement prompted questions from the classes of shareholders who were not directly involved in the daily operations of the company regarding the independence of the appointed auditors and the fairness of the auditing process. As a result, less than one year after the EIC commenced operations, the practice of appointing
auditors was expanded to include auditors from outside the firm’s management circle. On April 11, 1601, at the General Court meeting on the day of the election of the new governor, the generality selected six “persons [...] to be general auditors of Treasurers’ Accounts and of all other the charges of the voyage.” The auditors who were appointed at this general court meeting were to “join with the former Auditors appointed by the Committees” to audit the accounts of the treasurer and other expenses and disbursements. The rule regarding the number of auditors who were required to be present during an examination of the books was also altered such that the general court required at least six of the ten appointed auditors to be present at these meetings (Birdwood, 1886, pp. 164-166). Presumably, the presence of three auditors did not provide an acceptable level of protection against collusion.

A direct examination of all disbursements, expenses, and the accounts of the company required a certain level of understanding of business transactions and market prices. Individuals trusted to work for the good of all stockholders were elected to be auditors. During the early days of the EIC, this privilege was a significant responsibility and involved an uncompensated commitment of personal time and individual human capital to the company. This lack of compensation for auditing services was the likely reason that difficulties arose in organizing auditor meetings and in persuading stockholders to serve as auditors. The practice of appointing auditors at a general court meeting was maintained for several years, although the numbers of auditors and the quorum needed for decisions were continually adjusted. For instance, on April 30, 1602, the General Court elected 12 auditors and requested that at least four of them cooperate to perform each audit. Only one name, Olyver Style, appears on the list of auditors elected for the years 1601 and 1602 (Birdwood, 1886, p. 218); all of the others were newly appointed to the position and most likely had no prior experience performing audits for the EIC. The names of these auditors were not previously mentioned in the general court minutes or in the court of committees. It is not known whether the high turnover among auditors was driven by an unwillingness of shareholders to perform uncompensated work or by a desire to rotate auditors by limiting their terms.

At this stage, accounting took the simple form of recordkeeping, and auditing was at an early stage of development (Baladouni, 1983). Despite the appointment of managers in practice, there was no formal separation between the duties of managers and those of shareholders. Shareholders, if they wished, could participate in management meetings and had full access to company records and correspondence. The shareholder meetings immediately followed the court of committee meetings, and the topics discussed therein replicated the topics of the management meetings.

Over time, the complexity of the EIC’s transactions increased. The company faced difficulties keeping the records in “a form and state” expected and accepted by the generality. By 1606, the company employed a bookkeeper to be responsible for maintaining the company’s books and obtaining the balances of its general accounts (Baladouni, 1983). The task of settling accounts was rendered more difficult not only by the late arrivals of documents both from the London offices and those from abroad, but also by the high frequency with which documents were reported to have been misplaced or lost. Moreover, disagreements arose regarding the methods that should be used to keep the company accounts. Company accountants were often late with their work and were unable to provide accurate information. In these situations, the auditors were asked to review the accountants’ work.

Stewardship accounting and auditing at the time of the terminable joint stock
The proprietorship accounting system was effective when the company’s operations consisted of one voyage and one list of subscriptions at a time. As the operations grew in complexity, voyages merged and the durations of multiple voyages overlapped. Simple voyage accounting became less useful. Different lists of the adventurers who financed various voyages added to the confusion. The closing of the accounts was also
made difficult by long delays in obtaining the necessary information from India regarding expenses, inventory, and cash balances, or the lack of information altogether; it was also complicated by the practice of leaving “remains” standing for long periods for different lists of shareholders (Baladouni, 1986). As a result, the accounting procedures and reporting had to be redesigned to provide a reasonably accurate picture of the entire entity on a more timely basis, with the adventurers treated as outsiders who had entrusted their property to the company.

As the company grew in size and organizational complexity, it was not possible for individual shareholders to be directly involved in its daily operations. The contract theory suggests that any change in contractual arrangements of any participant may influence all other members of the organization. Thus, given the increasing separation of ownership from control, a need emerged for more precise and detailed rules to guide the behavior of the organization’s participants. This stage of development in accounting and auditing corresponded to the stewardship model of organization and accounting. During this stage, shareholders became less active participants in running the organization. At the same time, largely intangible and difficult-to-observe shareholder-manager involvement in the organization intensified. This difficulty led to a change in the scope and frequency of audits.

The timing of the EIC’s introduction of the accounting method for transactions described in the literature by Baladouni (1983) is unclear. Nevertheless, accounting continued using a single-entry model, which did not provide financial information for shareholders (Baladouni, 1986)[10]. The Register of Letters of the EIC includes instructions on how accounts were to be kept (Direction to Richard Mountney for the keeping of the accounts of the second joint-stock issues at December 10, 1619, Birdwood, 1893, pp. 502-504). This letter instructed the accountant to keep not only a journal and separate accounts for every asset, but also to have the books audited every month. The accountants were also instructed to use diligence and to be skillful, true, and faithful in their actions:

9. And you shall not furnish nor lade anything what[t] sour in the Companies Ships or yarde or otherwise without receipts from those several officers, whom that shall concern to receive and to be accounted for the same, for in the Audit of your accounts you shall not be discharged without the said receipts.

10. Lastly, you shall use diligence and prepare all the said book to be Audited once everyone money at the least. And you shall have a special care and inspection to those officers who are employed under you in the Affairs of the said Company that they be skillful true and faithful in their several place and employment (10th of December, 1619) (Birdwood, 1893, pp. 502-504).

The inability of the stockholders who were already meeting only four times a year to directly monitor the actions of EIC management created a need to verify the management reports, which modified the auditing function. Over time, regular audits often arranged on a daily basis with an ad hoc committee were replaced by more regular audits conducted by auditors appointed by the court of committees. For instance, it is easy to observe from the primary sources that, as early as 1607, the court minutes refer to audits made at monthly intervals (February 3-27; June 5-30; July 1-31; August 13-28) (Birdwood, 1893, pp. 151-158).

At this stage, the auditors were selected from the court of committees. However, when suspicion regarding their reliability rose to a sufficiently high level, the generality sometimes demanded auditors be selected from among their own ranks to join the auditors from the court of committees. For instance, the 1619 Court Minutes read: “July 2 – [...] desire of the generality to have auditors chosen from among themselves: resolved to offer four or six, as they please and to dash and quell all other plots because nothing is done by the Company but will justify itself.” The minutes of the general court on the same day added: “[...] expect men to be chosen to audit them either with or without other auditors” (Sainsbury, 1870, pp. 282-286).
In addition to verifying transactions, the auditors helped settle disputes over the balances of the capital accounts of individual adventurers. Maintaining appropriate balances in these accounts was always a challenge. However, the greatest challenge before the EIC was to keep its servants from privateering. The contractual arrangements between the EIC and its factors have been previously described (Anderson et al., 1983; Hejeebu, 2005; Erikson and Bearman, 2006; Erikson, 2014; Sivramkrishna, 2014). This relationship involved considerations that were subtler than merely the prevention of theft by factors. At the time of the EIC’s founding, the prospects for gain were unknown. This lack of knowledge is why initial exploration and discovery was encouraged through customs allowances. Moreover, as a result of this uncertainty, the EIC exhibited a relatively high tolerance for factors who traded on their private accounts within Asia. However, the company prohibited its servants from trading goods between the East Indies and Europe (Hejeebu, 2005). Any suspicion of unaccounted for goods raised the concern of the court of committees, who then sent auditors to investigate the matter in the manner described as follows:

On January 27, 1614 the Court of Committees was to discuss a matter of Mrs Hawkins. “On January 29, 1614, after the funeral of Mr Hawkins the accounts of Mr Hawkins’ were ordered to be audited.”

On 17th of February, Nicholas Ufflett, “who is confirmed in the Company’s service” reported that Mrs Hawkins confessed she has one diamond worth 2,000 l. and smaller ones worth 4,000 l., besides other precious stones. Mr Ufflett promised to bring the book of intelligence and the proceedings of Capt. Hawkins while the Court decided to keep the dispute secret. Between February 18-26, 1614 the debate concerning Mrs Hawkins’ stones was resolved and she was presented with 200 jacobs as formerly intended (29th of January, 1614) (Sainsbury, 1870, pp. 273-278).

The large scope of the EIC’s operations and the engagement of stockholders with diverse roots and levels of commitment to the company sometimes led to interpersonal conflicts. In cases of ill will, these conflicts involved mutual accusations and could be moved to the General Court of the EIC. In these situations, company accounts were audited at the request of shareholders to determine whether these accusations were justified:

Petition of Mr Mountney, complaining of unkind speeches used by Mr Treasurer, concerning his accounts: resolutions thereon. Auditors to view the treasurer’s accounts, as he desired (July 4-7, 1615) (Sainsbury, 1870, p. 416).

Request of the Treasurer to have his accounts audited by “some the generality,” having heard that they have been questioned and suspected (1st-3rd of March 1614) (Sainsbury, 1870, p. 280).

Auditors were also asked to check the books to see if there was any suspicion of bribes or the misuse of company resources, or to help company accountants clear the books. The story of Walter Mountford illustrates this point. The records are available in Sainsbury (1878).

At the meeting of the general court on July 25, 1623, Walter Mountford was asked to give an account of his business in Bristol and Ireland. According to rumor, pepper and cloves had been sold from the Lesser James (the ship) in Ireland. The presumed amount of this transaction was 1,000 l. Mountford was asked to provide details of the transaction, to reveal the parties involved, and to give an account of all transactions in which he was involved that were related to the EIC. He was already late in meeting these requests. When asked about the transaction in question, as well as other businesses, Mountford apologized for not remembering much because of the passage of time. However, he was able to remember that he had received approximately 700 l. on the company’s behalf. He promised to provide all necessary information and documentation within two weeks. Mountford’s case started another argument over the slackness of the company’s officers, the lack of information, and the difficulties in obtaining important documents when they were needed. As a result, Mountford was ordered: “not be no more employed until he has accounted.” This point of the agenda at the general court ended with the general conclusion that, in the future, “all their servants so employed to account for their disbursements within three, four days, while
things are fresh in memory.” More than two months later, on November 21, the Mountford case returned to the court of committees. The auditors reported their findings after auditing the documents. They found all accounts “so intricate and out of order that it will ask a long time to audit them.” Mountford’s disbursements were not vouched for and, according to the auditors, he was obligated to account for 1,500 l. A decision was made not to pay any money for his salary or to make any other payment until he had accounted for the entire amount (Sainsbury, 1878, pp. 143-181). On August 15, 1623, Mountford delivered the documentation (Sainsbury, 1878, p. 321).

By 1621, the EIC had compiled 80 pages of written laws and rules as Lawes (1621). This document listed the duties that should be performed by the company’s court of committees and administrative staff, which consisted of the governor, his deputy, the treasurer, the secretary, the auditors, and the accountants. These written laws also described not only the meeting procedures for the court of committees and the shareholders but also the responsibilities of the clerks who directed shipyards, naval stores, the slaughterhouse, and warehouses.

An important problem facing the company was monitoring officers, such as treasurers, captains, and factors, who exercised direct personal control over company resources and who were subject to moral hazard[13]. These officers were accountable to the court of committees, whereas the court of committees, the governor, and the deputy governor were accountable to the general court. The company also had an independent function to scrutinize the actions of those being accounted and to report these actions to those responsible for accounting; this function was performed by the auditors in the court of committees and the general auditor.

The auditors in the court of committees, who were elected by this court, were instructed “to search out the Truth whenever there was occasions of difference for matter of Accounts which concern the company and to deliver their opinions to the Court or also to determine and end those causes which shall be referred unto them” (Lawes, 1621, p. 68). These auditors were responsible for informing the court of any payment of cash dividends to stockholders and for auditing all books and accounts before the data from these sources were entered into the general books of the firm. In addition, the auditors searched for possible errors, negligence, or shortages within the company. If an inquiry or disagreement between the firm’s shareholders arose, the auditors of the court of committees were called on to “satisfy the Company concerning the performance of their said Laws or Orders” (Lawes, 1621, p. 69).

The standing orders also required the appointment of two “Auditors general” by the general court, who were required to audit accounts every quarter, assess the reasonableness of the interest rate on any borrowed funds, and confirm the fairness of other company expenses (Lawes, 1621, pp. 69-70). The standing orders gave the auditors general the responsibility to monitor records of the company’s general accounts to ensure that these accounts were fair and correct and to verify the details of each transaction. The reports of the auditors general were discussed with the auditors in the court of committees before they were submitted to the governor, the court of committees, and the shareholders of the EIC (Lawes, 1621, pp. 69-70).

The standing orders of the EIC included instructions for auditors regarding the performance of auditing services (Lawes, 1621, p. 70). For instance, the orders required an audit to be performed by several auditors, who were supposed to physically inspect every parcel and examine records to search for accountants’ miscalculations or other errors. The auditors were responsible for drawing up the account balances and diligently verifying the prices of purchased materials and provisions, and any disbursements. Any suspicious findings or errors were to be reported to the governor, the deputy, and the court of committees.

In addition to the detailed rules related to auditors and their practice, the standing orders included extended regulations governing the manner in which accounts were to be maintained.
Regulations in the Appendix of the standing orders included “the order and method that accountants general should observe and perform in the managing and digesting the accounts of the company” (Lawes, 1621, p. 75). This document not only formalized the organization of the company’s accounting but also regulated the duties and responsibilities associated with the maintenance of accounting books by officers, such as Treasurers, Clarkes in Stores in London, and Clarkes of the Imprest and Wages or Factories[14]. Surprisingly, accounting activity was the joint responsibility of the accountants and auditors because the standing orders required these groups to monitor one another. The auditors were charged with overseeing the work of the accountants so the accountants “shall not enter into the great books any amounts before they be audited and signed by the general auditor appointed by the court.” Concurrently, the accountants were supposed to “carefully review the work of the said auditors and if they find any error, they shall presently cause the same to be reformed” (Lawes, 1621, pp. 75-82).

**Accountability problems and the rise of the “salaried” auditor**

With the further growth of the business and the dispersal of transactions and inventories in time and space, simple verification of transactions was no longer sufficient. From 1623 to 1640, the contractual arrangements evolved further, leaving management of the company largely to the court of committees. The choice of the company’s secretary, accountant, auditor, and other officers was also “left to the Court of Committees who best know their abilities” (Sainsbury, 1878, p. 61). At the same time, the shareholders increasingly raised concerns about auditors’ independence in “perfecting the reports” especially when the financial performance was poor.

This stage in the development of the EIC took its accounting and auditing toward the financial accounting stage in Sunder’s contract theory. According to Sunder (1997), the three stages – proprietorship, stewardship, and financial reporting – are not mutually exclusive. The stewardship model includes the bookkeeping model, and the financial reporting model includes the stewardship model. Financial accounting emerges when equity capital is raised from a large number of shareholders who cannot be in direct contact with the operations of the business or its managers. Shareholders in such large organizations cannot actively participate in managing a company’s resources and they become vulnerable to the misuse of their resource contributions. At this stage, stockholders of the EIC no longer directly participated in the daily management of the company. At the same time, they were interested in receiving reliable information on whether the resources they contributed were well-managed and whether the aggregated transactions in the form of financial statements provided by the company’s management were accurate[15].

The practice of simple adjudication was still used in the EIC by auditors in the court of committees; these individuals were primarily hired to report to the company management. These auditors worked with accountants on a daily basis to “perfect” the financial reports of the company. The illustration of their work is presented below:

At the Court of Committees meeting on March 4, 1635, a written report by auditors was read concerning their examination of the accounts returned from the voyage of the Mary, in which they provide information about abuses and errors that were committed by the factors in India. The main errors were related to the exchange rate of eight trials to the local currency in Gujarat to support private trade (Sainsbury, 1907, p. 31). The court decided that the records would be further examined and compared with other accounts. Five members of the generality nominated by the Court of Committees were to meet the auditors to analyse the problem, to decide how to solve it, and to write new instructions to be sent to India to the president and the factors (Sainsbury, 1907, p. 32). On March 13, the auditors prepared information on the errors made and solutions to be implemented to avoid similar problems; this information was read and discussed before approval by the Court of Committees. Once agreed upon, the list of solutions was ordered to be sent to India
to ensure that “the Presidents and factors may observe and conform themselves thereto.” In addition, a general letter was sent to India to signify that “if any shall take up money upon interest or upon credit for particular accounts to be used for private trade or otherwise, upon discovery they shall be immediately discharged from the Company’s service, sent home and forfeit all wages due unto them” (Sainsbury, 1907, p. 37).

At the same time, a different group of auditors appointed by the general court and derived from the generality was responsible for the *ex post* verification of transactions. These transactions were aggregated into a report by accountants and verified by the auditors on the court of committees. These auditors met at least four times a year to audit the company’s accounts and were expected to attend shareholders’ meetings to answer shareholders’ questions alongside the auditors on the court of committees. The standing orders specified the number of auditors who should be selected by the generality and the number of auditors who should serve on the court of committees. However, it was difficult for the EIC to conform to these specifications. In 1623, only four auditors were elected by the general court despite the efforts of members of the court of committees to influence the auditor choices. Traces of these efforts can be found in the court minutes. For instance, on November 7, 1623, during the morning session of the court of committees, the issue of the following day’s elections was raised and the committee discussed potential nominees for the position of general auditor. During the meeting, “several auditors were nominated, but in the end resolved to be left wholly to the Court” (Sainsbury, 1878, pp. 168-169). On December 15, 1623, one of the auditors who had been elected one month earlier by the general court did not accept his election; therefore, the court of committees nominated someone else (Sainsbury, 1878, p. 210).

With the diffusion of ownership and increased separation between ownership and management, the old control arrangements were no longer satisfactory and new ones needed to be developed to ensure that all participants in an organization delivered their expected contributions. Auditors continued to perform the tasks they had performed in the stewardship stage while significant changes were made.

The first challenge was the increasing difficulty of finding people who were able and willing to devote the time to auditing the company’s accounts. In the proprietorship and stewardship stages, the auditors of the EIC were drawn from the shareholder class. The EIC’s expanded operations caused the auditors’ work to be more detailed and time consuming. Few stockholders were interested in providing mostly uncompensated audit services to the company. The company innovated – the auditors would be fully compensated[16]. More importantly, it was decided that the auditors no longer had to be shareholders of the company. This topic of hiring professional auditors for full-time engagement was discussed in the court of committees on February 4, 1635. Mr Handson was one of the auditors accused of “not giving sufficient attention to his business by reasons of his many other employments” (Sainsbury, 1907, p. 11). This situation led to the decision that the then-current auditors would be replaced by a single auditor who would work full time on auditing the company’s accounts at a fair salary and “to be assisted in cases of extraordinary business by Mr Handson, who shall be paid for his service as shall be thought fit” (Sainsbury, 1907, p. 11).

The replacement of elected auditors with salaried staff alleviated the problem of independence. Although there were still written rules on the selection of auditors by the general court, the task was left to the court of committees, especially at a time of prosperity for the company. Predictably, auditor independence became an issue, especially when financial information was missing or the company’s financial performance and standing were deemed unsatisfactory. With trust at a premium, and because the auditors were selected by the court of committees, certain shareholders accused the auditors of doing management’s bidding. Although the issue of independence was frequently raised, surprisingly, the stockholders rarely exercised their prerogative to select auditors for the
The new EIC policy on hiring salaried auditor raised new questions about who the auditors should report to. The following case illustrates this conflict. In 1635, at a meeting of the general court, an instruction was issued by the court of committees “which forbids them to see the Company’s accounts or letters, or to be present without special leave and direction at the first reading of the letters from India or Persia.” This order caused another heated debate related to the accountability of the company’s officers. After the order was read, “an honorable lord observes that they thought that the Secretary, Auditors, and Accountants were the Company’s officers, but he now finds that they are servants of the Court of Committees, though paid by the Company.” Another member of the generality mentioned that, “the Governor and Committees have salaries from the generality and ought not to find them by their particular orders, a course which is not authorized by the Charter of the Company.” The governor defended the court of committees, explaining that this procedure was undertaken for the good of the company because certain sensitive information should not be discussed in public places and because it was prepared with the permission of the other committees. In response to the accusation that the secretary, auditors, and accountants were “made thereby servants of the Committees and not of the Company,” the governor stated that “this is not the case, for the Committees assume no such power over them, but look upon them as the Company’s officers; while the Committees desire to be looked upon by the generality as fellow members with them of the same body, but privileged above them by virtue of the power given them by His Majesty’s Charter.” The governor continued, explaining that the members of the court of committees “do not admit of the gratification given them for their services being called a salary” (Sainsbury, 1907, p. 18). In response, one member of the generality noted that “gratification being made certain becomes a salary” and that the committees are not commanders over the generality but directors who have the power to make such orders with the allowance and approbation of the general court. The final decision was to alter the phrasing and style of the order and to present it to the generality for confirmation at the next quarterly court (Sainsbury, 1907, pp. 13-70).

In 1640, despite questions asked in the general court about the work of the court of committees, the choice of accountants and auditors was left entirely to the latter body, which was thought to possess the best knowledge of the candidates’ abilities. The court of committees also decided to form a special committee to supervise the auditors and accountants who were supposed to cooperate and present financial information on a regular basis, a precursor to the audit committee of the board of directors in contemporary organizations[17].

**Conclusion**

This study augments the historical literature on the evolution of accounting and control systems by seeking a better understanding of the role of auditing in the EIC and the change in the way that audits were conducted as a result of operational and institutional changes in the company. From the standpoint of research in accounting and the history of auditing, this study has analyzed the evolution of auditing during a period in early modern history in a specific setting – the single case of the EIC.

The findings of this study have been informed by the Sunder’s contract theory of the firm. The contract model allowed us to examine the development of accounting and auditing and to connect these functions with the innovations that have emerged in organizations over
time as accounting and auditing have evolved in accordance with changes in the contractual forms of organizations. As proprietorships grow to include one or more levels of hired managers, simple bookkeeping must be supplemented by the elements of stewardship accounting; sufficient dispersal of ownership among a large number of shareholders forces the stewardship model to be supplemented by a full-fledged system of financial reporting.

The EIC originated not as a proprietorship but as a group of individuals who pooled their capital to undertake risky but potentially lucrative maritime trade with Asia. The scope and level of involvement of the various shareholder groups within the company’s operations were often determined by the status of the individuals. The merchant shareholders received cash and goods from the company while the firm’s other shareholders received only cash after the imported merchandise was sold. Merchants stood to profit handsomely from the transfer of merchandise to them at wholesale prices, raising disputes over the fairness of not using retail prices.

Initially, with discrete subscriptions and accounting for individual voyages, most tasks at the EIC, including auditing, were performed by shareholders who volunteered their time to the organization and who acted under the direct orders of various shareholders of the company. As the enterprise grew over time to include multiple overlapping voyages financed by a larger number of shareholders, inventories were held at many locations at home and abroad and were managed by factors, captains, and other employees. Moreover, the ability and willingness of uncompensated volunteers to audit the increasingly complex operations, disbursements, accounts, and financial reports waned. Their credibility also waned in the eyes of the other shareholders, particularly when the company’s performance was poor and information regarding this performance was delayed or suspicious in nature.

At its inception, the EIC adopted an accounting system in which all goods and supplies that were prepared for a voyage, and the proceeds from the sale of the merchandise, were to be counted, checked, and recorded. After a ship returned and its merchandise was sold, the net difference between resource inflows and outflows was calculated and distributed to stockholders in the form of divisions (initial capital plus dividends). If accounting is the answer to the practical problems of running an organization, why is auditing needed? Auditing was developed because of the need to separate organizational ownership from control. This need becomes more exigent as organizations grow in size. Auditing is required because a large and therefore diffuse group of shareholders cannot possibly manage the daily operations of an organization and must entrust their resources and significant associated rights to the discretion of the organization’s management. The task of auditors is to verify that company management is true and fair in its reports to shareholders.

As the active involvement of ordinary shareholders faded, concerns over the role and independence of accountants and auditors became more pronounced. Within its first four decades, the EIC’s accounting and auditing system transitioned through three phases of development: classical bookkeeping, stewardship, and a more market-oriented system of financial reporting. Auditing processes evolved in response to changes in the size and scope of the EIC’s operations and its environment.

This paper makes three important contributions. First, it presents a dynamic picture of the evolution of auditing of the EIC during the critical first four decades. An understanding of these developments in response to the growth of business, organization, and governance issues that arose is a valuable addition to the well-known prior studies cited herein, which have already provided detailed snapshots of the company’s accounting and auditing control system at various stages of its development.

This paper also contributes to the broader body of knowledge on the development of auditing and control in the early periods of joint-stock companies. This case study provides insights into how auditing in the EIC evolved from a simple adjudication of allowable spending to ex post verifications of financial transactions.
This paper also traces and links the evolution of the EIC’s accounting and auditing control system through the bookkeeping, stewardship, and financial reporting stages, as suggested by the Sunder’s model. Starting with the bookkeeping model of individual traders, the company soon found this model to be inadequate for its needs and supplemented it with stewardship elements necessitated by the inability of several hundred shareholders to directly manage its operations. With the number of shareholders continuing to grow, the expanding need for capital to finance the growth, and the identity of shareholders continuing to change as ownership shares were traded, elements of financial reporting had to be introduced to meet the demands of the capital market. This study is the first to document the link between forms of organizations and the corresponding accounting-auditing systems designed to meet their governance needs.

The subsequent years, which are outside the scope of this paper, silently witnessed major changes in corporate strategy when the company started to believe that “profit and power must go together” (Robins, 2012, p. 50). This gradual change in the company’s strategy and the concomitant focus on administrative service and power changed the business context of the EIC’s operations. The development of an extensive system of internal and external auditing in the first four decades of the company was attenuated and changed to serve its very different needs.

Further extension of this research could offer accounting and auditing historians an opportunity to analyze the forms and possible alterations in the contractual arrangements among participants in the EIC and the use of control mechanisms to reduce agency costs. This case helps elucidate the nature and dynamics of changes in the accounting system and auditing of the EIC. However, further studies in a different setting – especially outside the British Empire – could shed more light on the differences in the development of auditing in alternative settings and the possible social, institutional, and environmental factors that influence accounting and auditing practices.

Notes

1. Book 2, Chapters 7 and 8 of Kautilya’s *Arthashastra*, a third-century BCE Sanskrit classic (see English translation by Kangle, 1963), presents an extensive treatment of auditing. See also Shyam and Sunder (2008).

2. The manorial audit can be summarized as an oral examination and a “structured process designed to challenge the fairness of the accounts rendered and arrive at an agreed value” (Maltby, 2009, p. 231).

3. In its original charter, the EIC was allowed to remove specie from Britain to conduct business during its voyages. This policy created a conflict, because mercantilism – the predominant economic ideology of the era – was incompatible with international trade involving outflows of hard currency. Specifically, mercantilists believed that national wealth was determined by a country’s precious metal reserves and, therefore, they promulgated protectionist laws that favoured national industries at the expense of foreign producers. The implications of all of these considerations for the EIC are apparent in the provision in its charter that allowed the firm to export hard currency (silver) to conduct business abroad. Barber (1975) reviews these issues within the context of the EIC.

4. The “committee” was the person to whom a thing was committed or entrusted.

5. In the late sixteenth century, independent Dutch merchant groups were engaged in routine trade with Southeast Asia. In 1602, the states-general of the Netherlands initiated and helped finance the formation of the Dutch East India Company (VOC) (Dutch: *Vereenigde Oost-Indische Compagnie*), which was granted exclusive monopoly rights to engage in trade with Asia in 1602.

6. Freedom is analogous to the fee on admission to the regulated company (i.e. a sign-up fee).
7. The Elizabethan term “adventurer” more accurately captures the risks associated with equity investments than its modern equivalent “shareholder.”

8. “viij hh” refers to some monetary amount.

9. Since the company originally had an open-book policy, it was possible for the books and other documents to be removed from the accounting office by accountants or shareholders. The rule of making the books available only to authorized persons was formalized in the standing orders, which requested that “they shall not deliver out of the Company’s house any of the originals, or copies of letters, journals, consultations, commissions, accounts, or other writings which do concern navigation, Trade or other secrets of the said Company, neither yet shall they suffer any of them to be perused or read in the said House by any person or persons, but only by such which shall be authorized thereunto by the Court” (Standing Orders, 1621).

10. In 1613, a new method for financing voyages was adopted whereby capital was no longer subscribed for the term of a single voyage but for an extended period (Chaudhuri, 1965). With the creation of its first joint-stock company in 1614, the EIC had a single pool of capital to which all investors contributed, although share ownership was still limited to a four-year subscription and was to be paid in equal amounts during the subscription period. In 1617, the subscription of stock was extended by eight years, forming the second joint stock (Scott, 1912, p. 156).

11. In the company records, “l.” stands for pound sterling, a British currency unit currently denoted by “£.” The term “l.” is derived from “libra” or “livre.”

12. For more examples, see The Calendar of State Papers, Colonial Series, East Indies, China and Japan, 1513-1616 (Sainsbury, 1870, p. 336, 348, 365, 441, 442, 450, 469, 498).

13. This problem has a more subtle character because of the EIC’s political ties and financial structure, and because of the environment in which the company operated.

14. For a more detailed analysis, see Baladouni (1983, 1986).

15. See Baladouni (1983, 1986) for a description of financial reporting in the early years of the EIC.


17. However, the new invention did not last long. On the one hand, the shareholders did not want to take an active role in supervising the auditors; on the other hand, they perceived auditors to be less than independent of management. As a result, the role of the auditors in the EIC declined and eventually merged into the function of the accountants. By the time permanent stock was issued in 1657, auditing and auditors were practically nonexistent in the EIC.

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Further reading


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Failed crisis communication: the Northern Rock Bank case

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Abstract

Purpose – Although granted funding from government agencies, Britain’s Northern Rock (NR) Bank experienced a depositors’ bank run in 2007. The purpose of this paper is to explore bank managers’ and the Triparties’ communications, in their failed attempt to reassure depositors during the crisis.

Design/methodology/approach – The paper is based on content analysis of information given to depositors by bank managers and the Triparties via mass media. The theoretical concepts of rituals and masking were utilized.

Findings – Results suggest that nonfinancial reporting supersedes financial reporting. Rather than hidden losses, bank regulators’ and politicians’ discussions of emergency funding for NR was the crucial incident signaling “something going on.” Even positive statements by prominent organizational actors may have signaled serious problems that compromised NR’s “business as usual” stance.

Practical implications – Collective action manifested in a bank run is triggered by reasons other than numbers in financial reporting. The research results indicate a need to consider how regulatory authorities act during financial crises.

Originality/value – Previous studies concluded that sensegivers must be consistent in framing communication to sensemakers. Sensemaking requires that the crisis communication is also consistent in the sensemakers’ framing. Because it is difficult for sensegivers to reshape the collective sensemakers’ frame, successful crisis communication requires that sensegivers change their communication to match the sensemakers’ frame, including symbolic actions. Additionally, a bank run is characterized first by loss of trust in financial reporting; second, in nonfinancial reporting; and, finally, in the sensegiving actor: a domino effect.

Keywords Crisis communication, Regulation, Bank run, Collective sensemaking

Paper type Research paper

1. Introduction

Communication in times of crisis is a neglected theme in accounting research (Andon and Free, 2012, 2014; Holland, 2010). This is particularly surprising in the case of banks, given the severe financial crises they have suffered since 2007. The failure of Lehman Brothers, UBS, Barclays, Northern Rock (NR), Royal Scottish and many other banks has been the subject of constant media attention and serves as a manifestation of the need for management and regulators to stabilize crisis situations. Yet, media communications by top-level managers and financial regulators in times of crisis is still a largely unexplored and under-analyzed area of research.

The literature on crisis communication has concluded that crises tend to generate different stakeholder interpretations of events, causes and responsibilities (Alink et al., 2001; Boin et al., 2009; Hall, 1997/2003; De Vries, 2004). Interpretative schemes – or frames – can differ among and between senders and receivers of information (Boin et al., 2009), with both real and symbolic actions being interpreted in a frame by stakeholders (‘t Hart, 1993; Boin et al., 2005). Crisis communication of symbolic and real actions can be seen as an attempt to shape collective interpretations of crises, to demonstrate management control over them and to minimize the gravity of the crisis (‘t Hart, 1993; De Vries, 2004). Investigations such as audits have a conspicuous function (Andon and Free, 2012, 2014) in these shaping efforts. As Andon and Free (2012) demonstrated in their case study of a salary cap scandal, crisis communication introduced staunch criticism and the challenges accompanying conflicts of interest. These challenges impugn the credibility of auditing as a shaping effort, creating a need to bolster it in the public eye through a variety of strategies. Andon and Free have shown that the strategies to dismantle critiques and shape efforts are
central to an ongoing dynamic process of legitimation during a crisis. One conclusion is that information senders must expend considerable effort in their consistent framing of strategies. In the case studied by Andon and Free, it could also be argued that shaping efforts were used to create faith in expectations of a positive outcome of the crisis. When such expectations are present, trust is established, virtually by definition (Luhmann, 1979).

In the area of crisis communication, studies have underscored the role of the media in the social construction of reality (see, for instance, Gamson et al., 1992; Taylor and Perry, 2005). With the exception of Chen et al. (2014), Holland (2001) and Holland and Johanson (2003), few researchers have analyzed the way in which collectives of market actors make sense of financial and nonfinancial reporting information, however[1]. Their three studies have concluded that information about intangibles – facts not described in numbers – are privately exchanged in reports to financial analysts and fund managers, enabling the involved parties to calibrate their interpretations. But when managers report to laypeople, such as depositors, the communication process seems to be much more demanding for the manager, who receives little feedback about the collective sensemaking process. Furthermore, regulators and auditors lend their reputations to banks, thereby assuring the public of the quality of information produced and the credibility of managers concerned. Thus, intangibles concerning reputation and credibility of top management and regulators also became a major issue with depositors.

There seem to be few studies of laypersons’ collective sensemaking processes in financial crises (hardly surprising given the methodological problems) – merely studies of sensemaking in teams in crisis (Weick, 1995).

This paper critically examines the crisis communication failure of Britain’s NR Bank[2], a high-profile mortgage and savings bank faced with a rare situation: the first depositor bank run in 150 years, followed by a destabilized period that ultimately led to its nationalization in February 2008. Yet, as NR’s CEO, Adam Applegarth, has stated: “Ironically, it was the announcements and the leaking of the backstop [the financial emergency support] that caused the retail run, and it was the retail run that reduced our liquidity” (House of Commons Treasury Committee, 2008, paragraph 27). Even at the height of NR’s crisis, the Governor of the Bank of England (BoE) described NR as solvent, and the Triparty Committee (or “the Triparties”) – BoE, Her Majesty’s Treasury (Treasury) and the Financial Services Authority (FSA) – attempted to manage the crisis. The rare case of the depositors’ bank run offers an analysis of the crisis communication process from sensegivers (regulators and NRs top management) to sensemakers (depositors).

The aim of this study is to examine how NR’s top management and the Triparties failed: through an inability in their crisis communication to instill trust in NR among its retail depositors. This paper deals with the problem of dysfunctionality in the interplay between financial and nonfinancial reporting through two research questions:

RQ1. How was the crisis communication of the bank’s management and the Triparties, which was distributed via mass media, intended to reassure depositors?

RQ2. Why did their crisis communication not make sense to depositors or provide a plausible explanation of the role that the bank and the regulators played in stabilizing the bank’s critical situation?

By focusing on media releases, the crisis communication is analyzed with the use of theoretical concepts of framing strategies from ‘t Hart and colleagues (see e.g. Boin et al., 2005, 2009; ‘t Hart, 1993).

This paper contributes to the literature by providing a plausible explanation for the failure of NR’s and the ‘Triparties’ crisis communications. Despite many potential success factors on the sensegiving side (Boin et al., 2009, p. 100); despite the fact that the media did not play a crucial negative role, which it usually does in cases of failed crisis management
(Brändström and Kuipers, 2003); and given that different tactics were in place to communicate information to stakeholders (Andon and Free, 2012, 2014), the crisis communication processes obviously failed. The information communicated by NR’s top management and regulators appears to have been sincere, but it did not make sense to depositors during the crisis. A successful crisis communication requires sensegivers to provide information that matches the frame of the sensemakers, as it enables a desirable interpretation. It is the sensemakers’ interpretation and their subsequent actions that set the stage for the outcome of a crisis. It is insufficient to concentrate merely on communicating facts through financial and nonfinancial reporting, which can be meaningful in the sensegivers’ frame, but not in the sensemakers’. Sensegivers must also consider the symbolic meaning of all major actors, such as the regulators’ rituals of assurances and solidarity in the sensemakers’ frame. The sensegivers failed to accomplish consistency, which, according to Andon and Free, is necessary in the sensegiving frame but also, importantly, among all the framing activities in the sensemakers’ frame.

A bank run by depositors acquires a domino effect. First, a bank’s financial reporting is questioned, followed by mistrust in the company’s nonfinancial reporting, and, finally, calling the bank as an institution into question. When the bank run started, the final brick fell because of the first step: loss of trust in the nonfinancial reporting. Not even a guarantee from the ultimate guarantor could save the bank then.

The structure of this paper is as follows. A review of a selection of previous studies of crisis communication is followed by an introduction of the theoretical framework. The history of NR is then reviewed, followed by a description of the method, presentation and analysis of the data. Crisis communication is analyzed at NR and the Triparties. This paper also deals with the role played by such stakeholders in the crisis communication process as the news media, which plays a significant role in the construction and contestation of crises (Hall, 1997/2003). Following are results of the failure of crisis communication, conclusions and suggestions for further research.

2. Prior studies of crisis communication

Studies of the interaction between accounting information and its calculative practices and the ways in which it affects users of information in times of crisis are typical research topics in the social studies of finance (for an overview, see Vollmer et al., 2009). Its scholars maintain that in order to understand how accounting information affects market actors, it is necessary to understand how both senders and receivers frame their messages and their interpretations.

Karl Weick (1995) identified Goffman’s (1974) term “frame” as useful shorthand for indicating the structure of the context of interpretation. According to Goffman, conceptual frames are interpretative schemes used to structure and give meaning to an individual’s experiences and behavior; thus, frames organize experiences and behaviors. “Is this a crisis or a temporary misreading of a financial result?” the interpreting person may ask. “Is this a mistake or a crime?” The chosen frame will guide the collective interpretation.

During a crisis, however, when trust in numbers has been lost, stakeholders’ opinions of a particular bank as a “good bank” are called into question. Although the meaning of a message can never be fixed in advance because the “politics of representation” (Hall, 1997/2003, p. 274) – the continuing struggle over meaning – always exists, financial reporting is never enough when trust in numbers has been lost. Many other symbolic activities concerning the actors must be undertaken in order to preserve stakeholders’ trust, thereby evoking actors’ reputation framed through reputational management.

According to Michael Power (2007), the concept of reputational management emerged in the literature around the mid-1990s and was defined by Rao (1994) as the outcome of “creating an account of an organization, embedding that account in a symbolic universe, and thereby endowing the account with social facticity” (p. 31). Because even small events
may cause reputational damage to an organization and its managers, every organization must manage its reputation carefully, by creating an image of how it wants others to perceive it (Power, 2004). This is not an easy task, because there are multiple ways in which an organization’s reputation may be damaged, and the causes and mechanisms of that damage may be subtle and difficult to grasp. Reputation management cuts across all functional domains in the organization and must incorporate every organizational practice and perspective (Power, 2007).

An organization’s reputation is built upon institutionalized values. In times of financial crisis, however, new or different values may challenge those values; some values may become less significant, and others may gain significance. Stabilization endeavors are usually attempts to strike a balance between the preservation of old values (the foundation of the previous reputation) and the introduction of new values (the renewal of the threatened reputation). It could be argued that several contesting frames are generated in a crisis situation (Boin et al., 2009). In the case of banks, bank managers and regulatory authorities would then try to calm worried depositors and manage stakeholders’ interpretations of the crisis in a way that would strengthen their interest in stabilizing the situation by creating the appropriate interpretative frame of the bank.

There are a few studies investigating the way financial actors try to frame the financial status of their organization from financial data and verbal information about the organization and the way these attempts are interpreted. Chen et al. (2014), Holland (2001) and Holland and Johanson (2003) have studied the bankers’, analysts’ and fund managers’ evaluations of a bank. They found that bank managers differ from analysts and fund managers in their belief that such intangibles as management quality, effectiveness of R&D, alignment of executive pay, financial performance measures and executives’ quality and strategy are important factors in evaluating a bank. Furthermore, bank managers viewed intangibles as a broad concept that included the accounting numbers attached to goodwill, other intangible assets on the balance sheet and other nonfinancial items, whereas analysts considered only goodwill to be important. Managers also perceived that intangibles rather than tangibles were the main variables for achieving competitive advantage. Although acknowledging the significance of intangibles, analysts prioritized tangible financial strengths as the main factors contributing to a bank’s performance.

Although opinions differ on the relevance of intangibles in assessing the position of a bank, it seems from previous studies that there are key interplays between executives and financial analysts/fund managers. The interplay provides analysts and fund managers with a dynamic exchange, with executives facilitating a base for adjusting perceptions of a company over time (Holland, 2001, 2003).

This case takes a different perspective, however, in addressing the way a collective of laypeople makes sense of the crisis communication of bank managers and the Triparties. In order to understand the dynamics of this collective sensemaking, studies of crisis communication in policy sectors should also be relevant.

In a study of 15 crises, Boin et al. (2009) examined the methods by which officials stabilize crises in order to protect their policies from radical changes and stop oppositional forces from gaining from the crisis. They found that the officials successfully preserve the status quo when:

1. they have a good stock of pre-crisis political capital with key media actors;
2. they cogently and proactively communicate their crisis frames;
3. they have had short a tenure in office; and
4. there is a predominant view that the crisis had exogenous causes, and they manage to have an “expert” commission as the main locus of official inquiry into the crisis (p. 100).
The opposition is successful when:

(1) the crisis is widely perceived to have endogenous causes;
(2) incumbents have had a long tenure in office;
(3) incumbents have recently been receiving a good deal of bad press; and
(4) they manage to instigate or capitalize upon a “political” (non-expert) inquiry (p. 100).

Crisis management involves attempts to shape collective interpretations of crises, to demonstrate control over them and to minimize their gravity. How should actors involved in the regulation of financial activities act in order to create and support the necessary trust in financial reporting? To answer this question, it is necessary to analyze what actually happens in crisis situations.

Alink et al. (2001) claimed that a “[c]risis occurs when the dominant ‘fit’ between institutional fabric and external appreciative frames is threatened or has been disrupted” (p. 290). They pinpointed the importance of policy decision making, the exercise of daily routines and patterns of authority, and the action and inaction of policy élites, asserting that: “[…] institutional crises are occasions for leadership” that “put sectoral élites to the test” (p. 290).

According to Alink et al. (2001), the process that leads to a crisis starts with the pre-crisis vulnerabilities of institutions – by which they mean public sector organizations. Although their vulnerabilities may become manifest because of new demands produced by changes in the environment, the existing social and political context may also create difficulties for those organizations trying to meet new expectations. According to Alink et al. (2001), it is not the crisis as such that explains vulnerability and decline in the legitimacy of public sector authorities; rather it is a combination of environmental factors with such endemic problems as ignorance and rigidity in the response to crises. Such catalyzing events as the deregulation of financial institutions may cause an asset price bubble to burst as well (Kindleberger and Aliber, 1996). Blame can be apportioned to specific actors through a timely press release or a critical report, suggesting that a certain agency could have foreseen the crisis event and acted differently. Alink et al. (2001) concluded that the real threat to public sector organizations occurs when the opposition manages to interpret some event as proof of institutional mismanagement and policy failure, and this interpretation becomes widely accepted.

Brändström and Kuipers (2003) have emphasized the difference between an instrumental dimension of public policies, on which efficiency, effectiveness and social consequences are evaluated; and a political dimension, on which the value of programmatic consequences is constructed. They note that “[a]ctions and events in public policy become politicized when influential actors in the political arena succeed in framing them as blameworthy violations of crucial public values” (p. 280). Actors may use interpretative frames both to assign and to deflect blame. Additionally, in both the studies of Alink et al. (2001) and Brändström and Kuipers (2003), media’s role was crucial in creating interest and momentum for a story.

Attempts at stabilizing a crisis situation may differ, but of utmost importance, it seems from prior studies, is the creation of a trustworthy story that will guide stakeholders’ interpretations of crisis events (Brändström and Kuipers, 2003; De Vries, 2004). Financial reporting alone would not constitute such a story. But when nonfinancial and financial reporting are interlinked, that linkage is crucial for framing in crisis communication.

3. Ways of framing in crisis communication
According to Luhmann (1979), loss of trust depends on one’s historic knowledge of another’s self-presentation and the way in which people behave in situations related to
self-presentation, which Lindenberg (2000) referred to as relational signaling. As Vosselman and van der Meer-Kooistra (2009) wrote:

A party will trust his partner if he understands from his partner’s behavioural signals that the partner has stable, co-operative behaviour, based on stable, normative goals. Trust is built gradually by monitoring these relational signals [emphasis added], two of which – ad hoc calculations and ad hoc accounts – signal a voluntary, personal commitment to the situational expectations (p. 275).

Appropriate behavior manifested in habits and routines may also be regarded as relational signaling. As Busco et al. (2006) have noted, “[h]abits of thought and routinised patterns of behaviour provide a sense of stability and predictability through time and space” (p. 14). Routines help agents to cope with uncertainties in their daily practice. Because trust entails predictability (Luhmann, 1979), routinized action is a precondition for trust. Although everyday routinized action does not attract enough attention to aid the recovery of trust, more visible forms, such as rituals – socially standardized actions with particular symbolic meanings – acquire significance in the context of crisis.

According to Leach’s (1968) definition, rituals are stereotypical behaviors that are potent in their communication of the actors’ cultural conventions, although impotent in a rational-technical (instrumental) sense when they acquire particular symbolic meanings in the context of a crisis (Andon and Free, 2012). Rituals must conform to people’s perceptions of proper procedure during a crisis, although they can also signal the possibility of a return to normality. Reassurance, purification and solidarity constitute typical examples of rituals enacted in times of crisis (‘t Hart, 1993). Andon and Free (2012) have provided three general examples of these rituals in the banking sector: rituals of reassurance (statements by bank officials that the bank is sound), rituals of purification (formal investigations and evaluations of bank performance) and rituals of solidarity (interbank conferences, interbank visits and formal cooperative efforts by bank managers in times of crisis).

Another activity aimed at restoring balance is masking – a concept derived from Goffman’s (1959) theory of impression management. In Andon and Free’s (2012) adaptation of masking to crisis situations, exactly that form of impression management is used to resolve conflicts and reduce the vulnerabilities that crises threaten to expose. The purpose of masking is to “project a business as usual image and downplay the seriousness or relevance of threats and potential damages and/or obfuscate the finer details of crisis responses” (Andon and Free, 2012, p. 133; italics added). In the banking sector, masking is the focus on positive developments, even as negative events are being neglected or the disclosure of serious issues and events are being obfuscated.

Expanding upon ‘t Hart (1993), six crisis management strategies were identified: under rituals (reassurance, purification and solidarity) and under masking (creating a business as usual image, downplaying and obfuscation). Both rituals and masking are used to persuade others to accept a certain interpretative frame of crucial importance in the collective sensemaking process. Six crisis management strategies are used in this analysis of the NR case.

4. The crisis communication actors and the role of news media

There are several insider actors in this case: NR’s top management, the Triparties, fund managers, fund analysts and such other stakeholders as the City of Newcastle. These insiders influence such outsider actors as the retail depositors and investors via news media. We assume that the NR’s top management and the Triparties are the most powerful actors in the crisis communication process – or at least the most potentially powerful – and may have the greatest influence on the retail depositors’ sensemaking process. Furthermore, we assume that retail depositors are informed primarily through news media, which include reporting on observable events and stock market reactions.
Financial news from companies, in particular, tends to pass through the news gate with little change (Morton and Ramsey, 1994; Schultz et al., 2014). Because the news must be delivered quickly, the various media often pass on company information as news. Thus "press releases continue to play a major role in the production of today’s news" (Sleurs et al., 2003, p. 193).

Press releases are not the only company information the media distribute. Editors’ comments and specialists’ analyses obviously serve a performative function. Andon and Free (2014) provided an example in their examination of the way two dominant newspapers framed accounting reports of a scandal in the National Rugby League in Australia. They found evidence of both coverage and statement bias in one of the newspapers that promoted favorable viewpoints on the scandalized team, based on the newspaper’s own commercial interests. Thus, it is critical, when undertaking media analysis, to separate opinion articles from articles that merely repeat a company message. Opinion articles constitute nonfinancial reporting, which may prove functional or dysfunctional for the company in question.

When a press release or a report reflecting a critical incident evokes media interest, the media can play a decisive role in creating a focusing event, exposing the vulnerability of, in this case, a bank (Alink et al., 2001). Mercer (2004) has also observed that information intermediaries, such as business journalists and financial analysts in research literature, usually decrease the credibility of management disclosures. The outcome of an exposed focusing event is not necessarily negative, however, as illustrated by the Greek financial crisis (Morales et al., 2014), in which the media may even have played a normalizing, stabilizing role (Ruef, 2000).

In the role of nonfinancial reporting, it may be assumed that the media are not merely mediators between an institution and the public – that they necessarily reflect reality. The media may be considered an institution (Hjarvard, 2008), and institutions introduce specific ideas, norms and values as constructed realities (Hall, 1980), which may serve as references in evaluating organizations (Pallas et al., 2014). Media interact in a dynamic process with the crisis actors who need "to convince the news-makers to their particular crisis frame, and, if possible support it" (Boin et al., 2009, p. 95). The extent to which political actors are able to have their version of reality accepted depends on the credibility of the actor’s crisis communication in the eyes of news-makers (Boin et al., 2009), which, in turn, depends on the communication being proactive rather than reactive (Fearn-Banks, 2007) and free from lies, understatements and denials of obvious problems (Boin et al., 2005).

Journalists reporting on NR may have had information from many sources other than public information: private contacts with fund managers and analysts conveying both facts and rumors that were eventually disclosed, private insider information from other banks, NR's shareholders, other hidden information producers and users, and the NR stock price changes as part of active opposition to NR’s management. Journalists’ private contacts may have affected journalists’ newsgathering and reporting and may have played a key role in the journalist’s “mosaic” building. In this sense, private sources played an indirect role in constructing the bank’s reputation and eventually undermining depositor’s trust. It appears that the financial news media used all these information sources to connect the professional insider world of bank management, regulators, fund managers, analysts and others to the outsider world of bank depositors, through their “news” production and their role in trust and reputation production. In that sense all the inside actors and the financial media play a role in constructing such bank intangibles as the public reputation and credibility of banks and their management during normal times (Rao, 1994; Power, 2007). These become bank “assets” in the public domain that, when combined with an individual depositor’s experience of the bank, helped to construct depositor’s trust in banks and their management. Yet, these private sources appear to have played a background role in normal times, when retail depositors are being informed primarily by public actors through the news media which report on observable events and stock market reactions. Furthermore, NR’s top
management and the Triparties seem to have been the most powerful public actors in the crisis communication process – or at least the most potentially powerful – and may have had the greatest influence on the retail depositors’ sensemaking process. The actual information environment of the bank is investigated in Section 6.6.

5. The study
5.1 Data collection
There are two research questions:

RQ1. How was the crisis communication of the bank’s management and the Triparties, distributed via mass media, intended to reassure depositors?

RQ2. Why did their crisis communication neither make sense to depositors nor provide a plausible explanation of the role that the bank and the regulators played in stabilizing the bank’s critical situation?

Because we assume that depositors, like most people, follow the mass media rather than reading reports of the banks’ analysts, we watched television, studied newspapers and a weekly magazine: The BBC; Britain’s “big three” quality newspapers The Times; The Guardian; The Daily Telegraph (Encyclopedia Britannica, website February 17, 2015); Evening Chronicle (EC) (the most-read newspaper in Newcastle, where NR is headquartered); The Economist; and Financial Times (FT). Although a British publication, The Economist is the world’s most widely read magazine in international politics and economics; four-fifths of its readership is outside Britain and over half is in USA (The Economist website, February 17, 2015). London’s FT is probably the leading daily business newspaper in Europe, providing a good source of information about British banks.

A search for “NR” in The Economist’s “Economist Historical Archive” from January 1, 2006 to January 1, 2008 produced 53 articles. A FT homepage search for “company” and “NR” for the same period yielded 1,565 articles, from which some 100 that reported relevant information were chosen. A search for “NR” on BBC’s homepage produced 148 items from April 1, 2007 to October 1, 2007. These data created a chronology of the most crucial events in the NR story.

Using the search term, “NR,” the Factiva database was used to find NR articles from April 1, 2007 to October 1, 2007 in The Times, The Guardian, The Daily Telegraph and Newcastle’s EC. This search yielded 2,283 articles, most of which were half-page or one-page articles dealing with a single aspect of an event.

5.2 Method of analysis
The data were analyzed in three steps. Primarily using public reports and early press releases, we first analyzed the public media image that NR had created to determine if public information played a role in destabilizing NR. Over 2,000 media articles and reports were categorized according to their descriptive content (Corbin and Strauss, 1990) and analyzed in two dimensions – NR as a bank and NR in its institutional setting – to provide an understanding of NR’s public image. The second step was to examine media articles based on press releases, analyzing the efforts of NR’s top management to make sense of the situation. Consistent with the theoretical framework (Andon and Free, 2012; ’t Hart, 1993), the analytical concepts in the two dimensions of masking and rituals were used as precepts for direct content analysis (Hsieh and Shannon, 2005): in the dimension of masking, business as usual, downplaying and obfuscation; in the dimension of rituals, solidarity, reassurance and purification. Codes were defined from theory before and during the content analysis.

The third step involved an iterative analysis of the coded data to obtain examples and illustrative quotations of each of the categories.
6. The rise and fall of NR

6.1 Before the crisis
NR experienced rapid expansion from its beginning in 1997, especially in mortgages and related instruments. Between 2004 and 2006, NR had increased its lending by 23 percent and had recorded a net lending peak of £33 billion – an increase of 14.2 percent (Northern Rock, 2007). Its loan portfolio seemed strong and capable of producing stable and profitable returns for many years (e.g. “Despite the price slide, a stout mortgage market makes this Rock as solid as ever,” The Daily Telegraph, October 3, 2006).

In 1997, the bank created an independent charity – the Northern Rock Foundation – to improve quality of life in the local community. Between 1997 and 2006, NR contributed £175 million to the Foundation (Northern Rock, 2007). The NR Foundation and NR were key sponsors of the Newcastle United Football Club and the Newcastle Falcons Rugby Union Club, among others. The media’s reporting of NR’s charitable work helped create a highly positive image of the bank as a responsible corporate citizen.

6.2 The crisis
On 27 June 2007, NR issued a surprise profit warning as the result of increased funding costs that lowered expected profit below its previous forecast. Not surprisingly, the price of NR’s shares fell dramatically, losing 12 percent of their value on the day of the profit warning alone. As the slide in share price continued, short sales of NR shares began.

NR’s last financial statements were issued on July 25, 2007, revealing improved liquidity positions and improved capital ratios. Profits for the period had not increased, however.

Between August 9, 2007 and August 13, 2007, NR’s traders were unable to secure full funding for the bank. According to CEO Applegarth, NR had access to some funding of short duration, but its officers could not be sure how long the markets would be closed. The first media indications of NR’s financing problems came on September 10, 2007, when a journalist wrote: “Northern Rock is in trouble because three quarters of its funding comes from the wholesale credit markets, which have effectively shut down amid the liquidity crunch” (“Weakened Northern Rock may face bid,” The Daily Telegraph, September 10, 2007).

At 8:30 p.m. on Thursday, September 13, 2007, BBC News reported that NR had asked for emergency financial support from BoE. At 7:00 a.m. on Friday, September 14, 2007, when the terms and funding facility were announced, NR’s online banking website collapsed, its telephone lines were jammed and long queues of desperate depositors began to form outside its branches. The first English bank run in May 1866 had begun.

In the crisis that followed, NR was squeezed on the wholesale market. In an effort to decrease its funding needs, the bankers tried to sell off assets. It became more and more difficult for NR to obtain funds, and the ensuing increase in borrowing rates exacerbated its difficulties. Ironically, NR was not insolvent (House of Commons Treasury Committee, 2008).

There were also different information events from a plethora of sources in the sensemaking and sensegiving of NR’s failure. Each event in Table I has also been categorized either in financial reporting or in various types of nonfinancial reporting, such as market events, depositor events, regulator and media events.

6.3 The retail depositors’ state
On September 28, 2007, a survey by GfK[3], was mentioned in The Guardian article, “Northern Rock hits consumer confidence.” The survey is briefly described in the article, which stated that the bank run negatively affected consumer confidence. Thus, not only the NR depositor’s confidence was punctured by the BBC TV report on September 13 announcing that NR was unable to fund itself and had sought emergency support from BoE; the confidence of retail depositors in general was affected. In two rounds of interviews
before and after three days of queues outside NRB’s branches, the consumer index dropped from −4 in August to −7 September — the lowest since December 2005.

Before the BBC report, ordinary citizens and depositors were unaware that NR was trying to acquire funds from other banks or that it had contacted the Triparties about its lack of liquidity. The BBC report, which included interviews with queuing depositors, started the bank run (House of Commons, 2008). Press coverage of depositors standing outside branches served as a strong illustration of a bank in trouble, and retail depositors

<table>
<thead>
<tr>
<th>No.</th>
<th>Date</th>
<th>Event</th>
<th>Newspaper Article and Information Category</th>
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<tbody>
<tr>
<td>4</td>
<td>August 20, 2007</td>
<td>it is revealed that NR holds few US subprime market mortgages and that it has nearly £500 million in commercial property loans. “Northern Rock denies subprime risk,” Financial Times, August 21, 2007.</td>
<td>Market event</td>
</tr>
<tr>
<td>5</td>
<td>September 3, 2007</td>
<td>the London Interbank market rate is fixed at 6.74%, its highest level since the collapse of the long-term capital management hedge fund in the late 1990s. “Senior banker envisages end to ‘irrational’ behaviour of markets,” Financial Times, September 4, 2007.</td>
<td>Market event</td>
</tr>
<tr>
<td>6</td>
<td>September 10, 2007</td>
<td>a journalist writes that NR is in trouble because financing in the wholesale market was unavailable. “Weakened Northern Rock may face bid,” The Daily Telegraph, September 10, 2007.</td>
<td>Market event</td>
</tr>
<tr>
<td>7</td>
<td>September 12, 2007</td>
<td>the Governor of the BoE, Mervyn King, states that the central bank will not intervene to bail out the markets. “Bank chief rejects bail-out,” Financial Times, September 13, 2007.</td>
<td>Regulator event</td>
</tr>
<tr>
<td>8</td>
<td>8:30 p.m., September 13, 2007</td>
<td>BBC News reports that NR had asked for emergency financial support from the BoE in August.</td>
<td>Regulator event</td>
</tr>
<tr>
<td>9</td>
<td>September 14, 2007</td>
<td>it is reported that the BoE will rescue NR by providing emergency funding. It becomes public information that NR has appealed to the BoE because it is unable to fund its obligations, which will be maturing in the next few weeks. NR’s customers are unable to access their online accounts or contact the bank by telephone. Long queues of desperate depositors begin to form outside NR’s branches “Drama ends after weeks of upheaval,” Financial Times, September 15, 2007.</td>
<td>Regulator event</td>
</tr>
<tr>
<td>10</td>
<td>September 15, 2007</td>
<td>newspapers print pictures of thousands of NR customers trying to redeem their savings after the BoE rescued the bank. NR’s shares plunge more than 30%. “Banking turmoil hits the street,” Financial Times, September 15, 2007.</td>
<td>Depositor event</td>
</tr>
<tr>
<td>11</td>
<td>September 14, 2007</td>
<td>NR’s CEO, Adam Applegarth, denies that takeover discussions are occurring. Various organizations, including The British Banker’s Association, call for calm. “Banking turmoil hits the street,” Financial Times, September 15, 2007.</td>
<td>Market event</td>
</tr>
<tr>
<td>12</td>
<td>September 15, 2007</td>
<td>the media reveals that NR had approached the BoE in August about its funding problems. “Drama ends after weeks of upheaval,” Financial Times, September 15, 2007.</td>
<td>Regulator event</td>
</tr>
<tr>
<td>13</td>
<td>September 17, 2007</td>
<td>Alistair Darling, Chancellor of the Exchequer, guarantees all NR’s deposits. Similar assurances are made to customers of any other lenders in the current turmoil. Interest rates for overnight borrowing surge to the highest level in six years. “Darling steps in to halt bank run,” Financial Times, September 18, 2007.</td>
<td>Regulator event</td>
</tr>
<tr>
<td>14</td>
<td>February 18, 2008</td>
<td>following two unsuccessful takeover bids, NR is nationalized. “Brown saw no other option”, Financial Times, February 18, 2008.</td>
<td>Regulator event</td>
</tr>
<tr>
<td>15</td>
<td>November 17, 2011</td>
<td>Virgin Money announces it will purchase NR. The deal is expected to be finalized on January 1, 2012. “Virgin builds its high street bank upon the Rock,” Financial Times, November 18, 2008.</td>
<td>Depositor event</td>
</tr>
</tbody>
</table>

Note: Each event has been categorized as financial reporting, market events, depositor event, regulator or media event.
started to reclaim their money as worry turned to panic, with NR’s blocked switchboards and broken website. The depositors had little power except to withdraw funds.

There is limited knowledge about the state of NR depositors before and during the bank run. It is known, however, that the UK had a history of fraud and mis-selling of financial products. Many scandals had affected depositors directly: those surrounding Equitable Life in 2000, the Barlow Clowes failure in 1988, and BCCI in 1990s. These cases were scandals long before the NR failure in 2007 and continued during the bank run of NR, as court processes, disputes over guarantee schemes, and sentences were argued widely in media and in Parliament. In the case of Barlow Clowes, compensation was paid because it had failed to provide adequate supervision, but it was 23 years before the Treasury was able to recover most of the payments made to victims of the failure (“Barlow Clowes affair declared closed after 23 years,” The Guardian, February 7, 2011). The attitudes of NR’s depositors were probably also affected by the 2000 failure of Equitable Life, in which the savings of approximately one million policyholders were lost (“Equitable life scandal victims get extra compensation,” The Daily Telegraph July 7, 2015). And, when the BoE closed BCCI, the seventh largest bank in the world, 1.4 million depositors were threatened with a loss of their savings (Levy and Scott-Clark, 2007), further contributing to the context surrounding NR and their depositors. In addition, some of NR’s depositors were shareholders who were watching dramatically plummeting stock prices in the unfolding of and during the crisis, and they could not help but realize that something was going on. It is likely that all those events combined to affect NR’s depositors and create awareness of the fragility of banks and other financial services. NR’s depositors, then, were poised to be sensitive in the sensegiving process from NR and regulators.

6.4 The Triparties’ recognition of NR’s problems and the options pursued

When the interbank market froze on August 9, 2007, it was evident that NR would face severe problems. Its business model was dependent on short-term financing. The next day – on August 10 – the chairman and CEO discussed those problems for the first time, and the FSA contacted financial firms thought to be in difficulty. One of these firms was NR. On the next working day – Monday, August 13 – NR informed the FSA that it would indeed face difficulties if the interbank market remained frozen. Thereafter, the FSA and NR had telephone contact twice daily. Those talks were not made public, of course, so it was almost impossible for depositors to know if “something was really going on” at NR.

On August 14, 2007, NR and deputies from the Triparties had their first conversations, and the governor of BoE was alerted to the NR situation. Talks continued, the FSA and officials from the UK Treasury held discussions on August 15, and the chancellor of the Exchequer was informed of the situation. On August 16, 2007, the chairman of NR spoke directly to the governor of BoE by telephone about supportive action for NR. A few days later, Sir Callum McCarthy of FSA wrote a letter to the Chancellor of the Exchequer, stating that NR was facing grave problems.

On Monday, September 3, 2007, the Triparty Committee met for the first time to discuss NR. The governor of BoE, the chancellor of the Exchequer and FSA favored a takeover solution, but it was soon clear that no bank was interested in acquiring NR. Ultimately, NR was nationalized, and the situation stabilized. Later NR was sold to Virgin Money.

6.5 The role of other stakeholders

Until the public disclosure of NR’s request for emergency funding, several groups had expressed solidarity with NR in more than words. Less than a week before the depositors’ bank run, even as NR’s crisis was mounting and the bank had already made contact with the Triparties, the City of Newcastle announced that it would award NR the city’s highest honor – the Honor of Freedom. This was indeed a vote of confidence; the award had been
given to such famous and respected people as Nelson Mandela and Jimmy Carter ("Bank gets credited for its work," EC, September 6, 2007).

Fund managers and analysts are influential insiders (Chen et al., 2014; Holland and Johanson, 2003) but are dependent on information from companies to make precise judgments that can run to over 100 pages. Although they are not public documents, journalists can use snapshots from them for media reports. On June 27, 2007, NR issued a profit warning and its shares tumbled over 10 percent ("The Rock needs to reassess its strategy," FT, June 28, 2007). A profit warning may cause hedge fund managers speculative attacks, but it may also trigger sellouts from fund managers, as profit warnings may indicate that problems lie ahead, in spite of assertions from NR that its business model was solid and its future prosperous. In response to the profit warning, equity analysts downgraded the company. Other investors saw the plunging stock prices as time for a bargain. The consequences of the profit warning were debated among fund managers, analysts and others. This news and the upcoming arguments were framed by NR’s top management and are developed in the following analysis.

There were other activities known only to insiders. NR top management was engaging in talks with other banks to be acquired. According to Fallon (2015), Lloyds was the only one left in early September, before depositors started the bank run. It was not only other banks that had knowledge of NR’s funding problems, as FT’s Editor, Lionel Barber, said in a BBC interview, “I did not cause the Rock run” on February 4, 2009, there had been rumors for months about the problems at the bank but the paper was not published because of fear for driving NR out of business. Regulators knew, therefore, that this information was flowing among many insiders, but sought to stop it from becoming public, although they eventually failed. They could not control every journalist, as it would have been of great interest to newspaper editors to discredit the government in this indirect way. Thus, the overall impression is that insiders other than NR and the Triparties played a relatively small role in the crisis communication process.

On September 10, 2007, The Daily Telegraph stated that NR was in trouble because financing in the wholesale market was unavailable ("Weakened Northern Rock may face bid"). This information was likely gleaned from private contacts with fund managers’ and analysts’ access to private information based on known share price sales, drops in the share prices and NR’s financing problems, motivating the sale of NR shares. These private sources, which likely continued during the period of this research, illustrate the key role that insider actors may play in undermining depositor’s trust, yet information from these sources did not destroy the depositor’s trust. Thus, some actors represented a contested frame (Boin et al., 2009). Most actors – regulators, analysts, politicians and other stakeholders – seemed to share a “spirit of the times” concerning growth and increasing value in the financial sector. In the 12-month period before the crisis, financial media communicated established ideas of banks and markets (Holland, 2010). In essence, the public held a dominantly positive view of NR during this period. It made one frame dominant until the crisis unfolded. New insights and emerging events were framed by top managers, the board of directors and regulators. Not until the days that the crisis unfolded did the media also begin to use a different framing perspective from bank management and regulators, rendering actors more critical of the information being supplied by NR. Thus, the overall impression is that NR and the Triparties and other insiders played the most crucial role in the crisis communication process.

6.6 The role of media

Members of the public, including bank depositors, have no access to the internal communications of organizations; they must rely on the media for most of their information. NR’s depositors received their information from newspaper stories, business journal articles
and television reports, thereby connecting the public, stakeholders and the media and reinforcing perceptions and social constructions (see Berger and Luckmann, 1966). Before the bank run, when CEO Applegarth made a statement, it reappeared in several newspapers and in different placements in the same newspapers: under News, National News and Business News. At that stage, the newspaper seems to have referred to statements from bank officials with few comments and without any real analysis.

It was not until the BBC report on September 13, 2007 – the report that triggered the bank run – that media attitudes began to change. BBC Reporter R. Peston later explained his role to the Treasury Select Committee: he received information from several government, bank and Parliamentary sources, as reported in BBC News online (“I did not cause Rock run – Peston,” February 4, 2009). In the same article, FT Editor Lionel Barber was referred to as having said “there had been rumours for months about problems at the bank but his newspaper did not report them because it was ‘not in the business of trying to drive Northern Rock out of business’”. In addition, Daily Mail’s City Editor, Alex Brummer, said that journalists did not warn readers of NR. Brummer also stated that “We were asked by people at the highest level if we would restrain ourselves from publication.” of NR’s problem. (BBC News online: “I did not cause Rock run – Peston,” February 4, 2009). Regulators thus knew this information was flowing between many insiders, but sought to stop it becoming public, and eventually failed. They could not control all of the journalists, since it would have been of political interest for some paper to indirectly discredit the government.

After the bank run, media became more critical of NR. Journalists started to express their doubts that “business as usual” was a true description of the situation and began making negative comments about the bank’s public statements. Newspaper journalists tried to outline the consequence of the rescue in their editorials. A common text in various newspapers at various times after the bank run informed readers of the consequences to customers of the bailout. FT, which frequently covered the Triparties’ actions (not surprising, given its emphasis on business), focused more on short presentations about NR’s stock.

Besides transmitting official statements from companies, journalists use rumors as input in their articles. They may also “borrow” news from each other. After Peston’s release of the news that NR would seek support, other journalists immediately followed suit. It is impossible to know if they borrowed the news of a bailout from Peston or had their own inside sources. The day after Peston’s release, FT had a picture of FSA’s Sir Callum McCarthy and other key people – including the deputy governor of BoE – leaving a late-night meeting at BoE. The reader was told that the Triparties and NR declined to comment on the meeting but was informed that BoE would be bailing out NR.

After the BBC’s report on September 13, other media – FT, other local and national newspapers and television broke the silence and started to name NR and its severe problem for the first time. The media reporting started to have another content, as consequences of a bank failure for depositors and for Newcastle where NR had its head office, just to mention two examples.

6.7 The institutional context of failure[5]

When NR failed, financial stability in the UK was the cooperative responsibility of the Treasury, BoE and FSA, working in cooperation as the Triparties, with a Memorandum of Understanding outlining the responsibilities of each organization. As “the banker’s bank,” BoE’s responsibility is to deal with liquidity fluctuations in financial markets. And given its involvement in market and payment systems, it is responsible for identifying potential and systemic problems at banks and supervising the banking system as a whole.

The responsibility of FSA, before its abolishment in 2013 (in response to the financial crisis of 2007-2008) was to regulate the financial services industry. A quasi-judicial body
appointed by the Treasury, it had supervisory authority to identify improper behavior in the industry and to audit financial intermediaries. At the time of the NR crisis, FSA had the power and responsibility to audit individual companies, including banks. Being under investigation by the FSA was regarded as a sign that “something could be going on,” and the public was generally unaware that FSA was auditing a bank. Both FSA representatives and the company/bank officials work cooperatively in these audits, in a “gentlemanly” fashion. Any other behavior by an auditee is essentially unthinkable.

BoE and FSA shared joint operational responsibility for deciding if and when to notify the Treasury about problems or potential problems in the financial system. Its responsibility is to inform the UK Parliament of serious problems in the financial system and to propose measures to resolve these problems. To fulfill these responsibilities, a free exchange of information was needed on several levels between FSA and BoE, in order to foster a culture of cooperation and prevent independent collection of the same data. BoE’s deputy governor was on the FSA Board, for example, and the FSA chairman was on the Board of BoE.

At the time of the NR crisis, the Treasury chaired the Triparties’ Standing Committee on Financial Stability, with representatives from the FSA, the Treasury and BoE. The Committee’s purpose was to make policy and to coordinate action by the three authorities.

Although it is unlikely that the public understood how the Triparties worked, or even that it existed, most people probably had some vague sense that there was a functional forum of some kind for dealing with national financial crises. And the public generally trusted BoE and the Treasury, even if they knew nothing of the FSA.

7. The analysis

7.1 Financial reporting
Did public information about NR’s finances destabilize it? The media obviously sent mixed messages about the bank to the public: widely read profit warnings paired with the implication that NR could manage the situation. Funding turbulence in the capital markets was a concern for all banks – not merely for NR. Because NR had a portfolio of mortgages with low credit losses and a history of stable revenues, it seemed that it could actually be regarded as a safe haven. Thus, according to media reports, it seemed that NR’s crisis was caused by exogenous rather than endogenous factors (see Boin et al., 2009 for a general discussion of the difference between exogenous and endogenous factors).

Because the media’s signals were mixed, one would expect the public response to have been worry rather than fear, and worry does not cause a depositors’ bank run. A bank run is the result of contagious fear, well founded or otherwise. Yet, NR depositors stood in long lines to withdraw their savings – and not because of what they had read and seen in the media. NR had received no bad press in the good years (see Boin et al., 2009); all the news was positive or, at worst, neutral. Since becoming a publicly owned bank, it had been profitable and well known for its community service. It enjoyed public support.

If NR’s financial reports to the public do not explain the bank run, one must look elsewhere for an explanation. An obvious place is NR’s press releases, which the media picked up in short articles and which were meant to communicate management’s version of a crisis.

7.2 NR’s nonfinancial reporting
In this section, we use quotations from the media to illustrate how NR officials attempted to create the frame of interpretation on ongoing events that it wished to convey. Various masking strategies and rituals were used in an attempt to create this interpretative frame.

Masking strategy 1: business as usual. There were many suggestions in the media that NR’s future prospects were solid: a mere repetition of the past few years. In late June, NR had
communicated an improvement in capital efficiency and an increase in dividends. Risks were to be reduced, and the company still expected to grow at its then current rate of 20 percent. As CEO Applegarth communicated, NR was in better than shape than it had been five years earlier: the image of a solid and prosperous business in line with recent years:

It [NR] also plans [...] to improve its capital efficiency under Basel II rules that may allow it to return up to pounds 500m [million] in buybacks over the next few years. Dividends will also rise “noticeably” [...] In other words, the Newcastle-based bank is reducing its risks but still aspiring to grow at existing levels of around 20pc [percent] a year. The strategic changes will put the bank “on a much more sustainable footing than five years ago,” according to chief executive Adam Applegarth (“QUESTAR Worth ascending the rock-face despite rising interest rates,” The Daily Telegraph, June 28, 2007).

Throughout the crisis, NR continued to claim that it was business as usual. As late as September 15, 2007, in fact, when worried depositors were queuing outside its branches, the switchboard had collapsed, its internet site was gridlocked, and management had been engaging in talks with the Triparties for a month, Applegarth was still using the words “business as usual.” “I am saying that it is business as usual, maintains Adam Applegarth, […]” (Interview, The Daily Telegraph, September 15, 2007).

Applegarth’s statement was intended to assure depositors and borrowers that they would not be affected, but it did not help to stabilize the situation. The business as usual image may have had the unintentional effect of uncovering masking: that the real problem for NR was the credit crunch.

Masking strategy 2: downplaying. NR tried to mask the seriousness of the credit crunch threat by downplaying the problem that would arise if interest rates increased. Interest rates do rise in a credit crunch, and because NR financed long-term mortgages with short-term funding, it could end up borrowing at a higher interest rate than it was loaning its money.

CEO Applegarth was often cited in the media, and he downplayed the effect of the credit crunch on NR’s market: “I would expect residential (mortgage) arrears to tick up, but they’re coming from a low base and I don’t really see a credit crunch on residential lending.” (“Northern Rock announces fresh assault on the mortgage market,” The Times, July 26, 2007).

As the crisis continued, NR further minimized its severe situation. Applegarth described it as a global crisis rather than a funding crisis for NR and said that reductions would not result in layoffs. Throughout the crisis, Applegarth continued to downplay the situation:

If I was a depositor, and I am – my funds are with Northern Rock – and given the fact that it is backed by the B of E, it is probably one of the safest places to be (“Bank hit by rocky times,” EC, September 14, 2007).

Thus, NR downplayed the severity of the situation by masking reality, by denying the possibility of depositors losing their money. It was a clear attempt to avoid going public about the funding problem.

Masking strategy 3: obfuscation. NR obfuscated the disclosure of serious issues and events. When investors withdrew from the wholesale market, NR could no longer fund itself, and it is only a question of time before a bank without funding will fail. This was especially so for the fast-growing NR, as expansion demands liquidity. In an effort of obfuscation, the company confused the real situation for the public by insisting that it could still fund itself. As a spokesman was cited as saying, “We have continued to fund during these difficult conditions” (“N Rock acts on funding fears,” FT, August 16, 2007).

NR funding was represented as global and diversified. But on September 15, CEO Applegarth was cited in Daily Telegraph in an article labeled “Interview”; he stated that NR was unable to fund itself: “Life changed on August 9. That’s when all the markets just froze.
I still find it astonishing that global liquidity markets across every instrument were frozen.” And again: “London, the most liquid market in the world, effectively is closed.”

As the House of Commons Treasury Committee Report (2008) revealed, NR’s top managers were stunned. Their bank had been shut out of interbank lending, a sign that other banks had lost their trust in NR.

NR was clearly engaging in obfuscation. Although it was operating in a tight funding situation, its earlier statements suggested an ability to obtain funding from the market, but its later statements clearly demonstrated an inability. Although NR officials probably made their statements with the best of intentions, their obfuscation did not help to stabilize the situation.

Ritual 3: purification. As mentioned in Section 3, rituals of purification serve to demonstrate publicly what people perceive as the proper procedures that should be undertaken during a crisis and signal the possibility of returning to normalcy. Two examples of ritual response in crisis are the declaration of policy changes and the declaration of formal investigations supported by expressive language.

NR ultimately acknowledged that it had had problems with rising interest rates and funding, that they had solved them and that they had learned from them. The problem was said to have been solved by an interest rate swap[6], among other things. NR officials added that the bank had altered its policy on swap rates – the cost at which financial institutions lend each other money – to minimize the impact of future rate rises. (“Northern Rock warns rate rises will affect profits in 2008,” The Guardian, July 26, 2007).

The financial turmoil had increased NR’s borrowing costs, reducing the return on existing and new loans. Applegarth claimed, however, that NR would increase its earnings in the future by currently earning less. New rules for capital requirement would enable NR to free capital to fund more of its lending, he believed, a sign that it would decrease its dependence on creditors, and suggesting that the problem was solved. In addition to changed rules, Applegarth argued, capital would be freed and used for a share buyback – a sign that NR was well capitalized and had more cash than it needed:

Mr Applegarth said that new rules on the amount of capital that banks must hold to support their business meant that Northern Rock would be able to free up about Pounds 600 million, which would be used to increase its interim dividend to 14.2p per share, up from 10.9p in the first half of last year, as well as to fund more lending. Under the same rules, […] a further Pounds 300 million to Pounds 400 million, which will be used to pay for a share buyback (“Northern Rock announces fresh assault on the mortgage market,” The Times, July 26. 2007).

The problems with rising interest rates and funding had been identified, and were acknowledged by the bank, which declared that it was taking action to solve them. The management of NR tried to give the impression that it could manage the difficult external financial climate merely by changing its internal policies.

7.3 The Triparties’ crisis communication

There appears to have been no evidence of crisis communication from the Triparties in the news media before the bank run[7]. The Triparties’ actions became public during the bank run, and strategies of masking and rituals were performed.

Masking strategy 1: business as usual. The bank run at NR was an extraordinary event for the Triparties. Nevertheless, Chancellor of the Exchequer Darling tried to frame the situation as normal: “There is plenty of money in the banking system. We have a strong and stable economy” (“Bank hit by rocky times,” EC, September 14, 2007). The effort to create a business as usual image was not successful, however. The situation of the bank continued to destabilize.
Masking strategy 2: downplaying. When thousands of people were standing outside NR’s branches, no one could be certain of the consequences that the run at NR would create for the banking system and the economy at large. Would other banks follow the tragic destiny of NR, creating a systemic failure with far-reaching consequences? The severe consequences were downplayed. Mr Darling presented a situation in which there would be no problem to continue bank withdrawals:

This means people can continue to take their money out of Northern Rock. But if they choose to leave their money in Northern Rock, it will be guaranteed safe and secure, Mr. Darling said (“Darling steps in to halt bank run,” FT, September 18, 2007).

Although all depositors at NR were guaranteed their money, the situation was still not stabilized during Autumn 2007.

Masking strategy 3: obfuscation. When branches were closed, depositors were withdrawing their money, and other banks were unwilling to do business with NR, the economic outlook for NR was certainly grim. Yet, FSA made the following statement: “The FSA judges that Northern Rock is solvent, exceeds its regulatory capital requirement and has a good quality loan book” (“Bank hit by rocky times,” EC, September 14, 2007).

This statement may have been the truth, but it omitted what were probably the most important worrying indicators in the eyes of the depositors, in the sense that it gave the impression of diluting and hiding what was really going on. The depositors did not seem to be calmed by this information.

Ritual 1: solidarity. At the national level, there were gestures of solidarity. Again, Alexander Darling announced that the Treasury guaranteed all NR’s deposits, that the system for protecting depositors was currently inadequate and that the system was already under review. Those actions can be interpreted as a ritual of solidarity to NR, designed to calm depositors and reinstate trust in NR and the broader system (see, for instance, “Darling steps in to halt bank run,” FT, September 18, 2007).

The gestures of solidarity and reassurance seemed rather to have compromised the crisis communication of NR, rather than rendering it more trustworthy.

Ritual 2: reassurance. A vast variety of authoritative actors – MPs, financial experts, interest organizations, BoE – provided assurance that NR was sound. Treasury Select Committee Chairman John McFall urged depositors to stay calm and not to withdraw their money:

The fact that the Bank [of England] is willing to act as lender of last resort should be reassuring, because it means they think the problems are temporary (“Building society is bailed out by Bank of England,” The Times, September 14, 2007).

Ritual 3: purification. Ultimately, it became evident that the depositors’ guarantee system had to be overlooked in order to reinforce trust amongst depositors. The Triparties took the initiative to launch an investigation to review the current system, just a few days after the bank run:

The Financial Times has also learnt that the Treasury, the Bank of England and the Financial Services Authority have concluded that the current system for protecting savers, which only guarantees deposits up to Pounds 35,000, is inadequate. They have already begun a review of the system and are minded to opt for a US-style alternative, ring-fencing depositors’ money in the event of a bank’s failure (“Darling steps in to halt bank run,” FT, September 18, 2007).

This statement rather confirmed that the depositor guarantee was insufficient in the case of NR and did not stabilize the situation either.

8. Why did it not work?

NR’s management tried to stabilize the situation through its nonfinancial reporting and explaining and interpreting of financial measures. Until the BBC’s report on September 13, 2007,
in fact, the bank’s managers did their utmost to present NR as a well-respected and well-managed organization that had inadvertently and through no fault of its own found itself in a temporary funding crisis. NR’s rituals of purification, along with its various masking activities, were intended to support this self-presentation. In June, Applegarth had informed the press that it was business as usual and that the bank was in better shape than it had been a few years earlier. The bank’s strong reputation and the generally positive news coverage should have supported this attempt to frame the bank’s actions and should have provided a good chance of stabilizing the situation. NR officials really tried to manage the stakeholders’ interpretation of the news stories. Why did they fail? Their claims were in accordance with the criteria for managing crises that Boin et al. (2009) listed: they had sufficient pre-crisis political capital with key media actors and had not been the subject of bad press; they cogently and proactively communicated their interpretation of the crisis, without opposition from either experts or non-experts; and they indicated that exogenous causes had created the crisis. Perhaps the only weak point in NR’s public defense was the fact that its managers had extensive banking experience and were therefore unable to blame the situation on others.

Until the BBC report was issued, the media simply repeated what NR had told them. They were engaging in factual rather than investigative reporting. After the bank run, media reporting became more critical. Except for a few reports, NR officials were more reluctant at that stage to comment on the bank’s situation. Rather, media reports were grounded in the reporters’ interpretations of the Triparties’ actions, but restricted in their criticism. If there was a bias, it was still toward a positive view of NR’s recovery.

The Triparties played a neutral role, as they did not seek to manage retail depositor interpretations, but adopted a wait-and-see policy. Authorities performed the formal rituals as expected to ensure that they were publicly seen as acting positively, but offered little public PR support to NR. This underlines that we studied the effects of NR’s crisis communication on the retail depositors’ sensemaking until the bank run started.

Perhaps the Triparties should have exercised an intense PR campaign to strengthen the bank’s credibility with the City’s elite and with its own regional audience, which could well have saved NR. There could be many possible explanations as to why they did not; they could have allowed it to go to serve as an example and teach the market actors a lesson. All such explanations are beyond the scope of this study, however, because the authorities acted in their regular, ordinary way, although the outcome indicates that they should have acted in an extraordinary way. Given that the press was neutral to NR, there is, in fact, a case of the impact on collective sensemaking of the Triparties’ actions, but restricted in their criticism. If there was a bias, it was still toward a positive view of NR’s recovery.

The Triparties and NR’s top managers evidently believed that the financial measures, such as BoE’s temporary emergency funding and guarantee of deposits, would reassure stakeholders of the bank’s solvency. The Triparties had acted in accordance with their interpretation of the situation by guaranteeing NR’s customers’ deposits, extending...
NR’s line of credit and assuming that depositors would be reassured, but they were not. In fact, Brummer’s confession that “We were asked by people at the highest level” to be careful in their reporting indicates that the Triparties were not fully confident in their crisis communication.

As mentioned, the Triparties’ actions can also be seen as ritualistic: Alistair Darling performed rituals of solidarity, and the banking regulators performed rituals of reassurance. Yet, the very fact that they undertook the actions that they did was interpreted as evidence that NR was in serious and extraordinary trouble. Because the Triparties’ authorities had normally acted only at the market and system levels and had rarely communicated directly with bank managers about the viability of their bank, its actions raised rather than lowered suspicion, and its financial measures were actually detrimental to the public’s interpretation of NR’s nonfunctional reports. In hindsight, it is clear that the Triparties’ solidarity action served as a signal that they were helping a sinking ship, that NR was no longer able to influence its image and that the bank had failed. NR had lost control of its story. NR’s stakeholders initially trusted management’s representation of the situation, but the entry of banking regulators assumed by the press turned trust to mistrust and worry to fear.

Regulators in the UK usually work in secrecy. When the Triparties openly focused on NR, the public had reason to read it as an abnormal situation (see Luhmann, 1979; Busco et al., 2006). It appears that despite their intention of calming the situation, the Triparties did not fully realize that their conduct was anything but calming. Depositor’s trust in NR was based on the bank’s reputation, past performance and appearances (Sztompka, 2003), but trust vanished when it was known that the BoE stood behind NR. The relational signaling (Lindenberg, 2000) of reputation, performance and appearances had been broken. The bank run was a fact.

9. Summary and conclusions
This study of the NR case examined the bank management’s and the Triparties’ communication during the crisis that was intended to reassure depositors. Yet, trust in NR was obviously lost in the process.

The NR case clearly illustrates the difficulty of controlling public interpretations in an impending financial crisis. Paradoxically, the depositors’ bank run began immediately after NR had received a line of credit from the BoE. If financial reporting were to be taken literally, this would have been the final measure, sufficient to stabilize the bank. The stormy period would have ended. Yet, it did not. To the contrary, that is the point at which the real crisis erupted.

As with the crisis described by Alink et al. (2001), there were obviously underlying institutional vulnerabilities in the banking sector prior to NR’s crisis. New demands arose from changes in external banking conditions, as credit was no longer available on the interbank market. There was also opposition among some depositors against NR, illustrated by the fact that NR shareholders were selling before the bank run; NR’s public share price dropped from £10 on May 3, 2007 to £6.20 on September 3, 2007. In this sense, there was a framing contest typical of crises, as Boin et al. (2009) have mentioned – in this case, among depositors in their sensemaking process. But the situation of crisis communication differs from experiences in the Boin et al. (2009) policy-sector studies and from other similar studies reported by them. In the case of NR, there was no explicit framing contest by sensegivers via the media, and no active opposition attempting to take advantage of the situation by influencing depositors.

In fact, NR seemed to have had all the success factors mentioned by Boin et al. (2009), except for the long tenure of its management team. Neither did it seem that the media played a crucial negative role, as Alink et al. (2001) and Brändström and Kuipers (2003) assumed in their studies. It is true that after the BBC news story was considered large enough to merit
local, national and even global attention, the newspapers jumped in. The very fact that the news spread so widely did not mean that the media fabricated contesting frames, however. Nevertheless, NR’s top management and the Triparties did not succeed in creating the necessary story of trustworthiness (Brandström and Kuipers, 2003; De Vries, 2004) that would have guided the depositors’ interpretation of the crisis events.

So it can be asked: why did NR fail? One plausible explanation was the failed crisis communication from NR’s top management and the Triparties. A successful crisis communication requires that sensegivers provide information to match the frame of sensemakers. It is not only a problem to provide the “right” facts, manifested by financial and nonfinancial reporting; it is also necessary to consider symbolic rituals by major actors as regulators. According to Andon and Free (2012), successful crisis communication occurs when sensegivers are consistent in their crisis communication to sensemakers. However, sensegivers may have difficulties in reshaping the collective frames of laypeople. Sensegivers must therefore be prepared to adjust their information to match the frames of sensemakers. Then consistency is achieved, and faith in expectations will be established, creating trust amongst sensemakers.

Depositors differ from analysts and fund managers in their interpretation of companies. As professionals in the accounting field, analysts and fund managers rely on numbers, enabling them to explain reported numbers. Their analyses are neither free nor publicly available. Analysts and fund managers constantly monitor companies and are quick to respond to changes in numbers; they rely on numbers to make their forecasts as accurate as possible. Although the professionals acknowledge the significance of information other than numbers (intangibles), they prioritize tangibles (numbers) indicative of financial strength in their evaluation of a bank’s performance (Chen et al., 2014; Holland and Johanson, 2003).

Furthermore, analysts and fund managers are in meetings with company managers, which enable them to engage in a dynamic, mutual exchange of information. There is interplay between the actors, framing and interpreting in these face-to-face situations, which makes it possible for the managers to adjust their way of framing their messages (Holland and Johanson, 2003). All in all, the communication process that involves collectives of laypeople seems to be a much more demanding communication situation for managers. Perhaps because they are used to communicating with professional actors, they underestimated the crucial importance of symbolic action in public communication and caused the failure, despite good preconditions and despite a lack of outspoken opponents.

In general, one can claim that a bank run occurs when a bank’s financial reporting is questioned. The first phase in a fast-spreading financial crisis may be growing mistrust of numbers. Our study suggests that in the next phase, a negative interpretation of nonfinancial reporting from the financial actors may result. The public’s interpretation of nonfinancial reporting supersedes the interpretation of financial reporting. The first phase is followed by a loss of trust in the nonfinancial reporting of bank officials that was intended to explain the problems and, finally, the third phase – loss of trust in the bank itself – completes the domino effect.

NR’s failure also sends a message to banking regulators and politicians, who normally work at the systemic level. They may be well advised to avoid involvement with a bank in crisis, or potential crisis, unless they are prepared to achieve a full rescue. Limited involvement with stop measures may signal a disinclination to undertake the complete measures that stakeholders require.

9.1 Future research
The case of NR illustrates a rare financial phenomenon: a bank run. Although these findings are not necessarily generalizable to other financial crises, they may be relevant in similar situations: bank runs by professional investors in the wholesale market, for
example. More studies analyzing the relationship between financial and nonfinancial reporting—especially in crisis—are required. Maybe the financial reporting system needs to be reformed systemically, with consideration for the regulatory context, which may be country dependent (Holland, 1998, pp. 255 and 268). This is an especially urgent issue now, in times of algorithmic trading (based on numbers) and computer-generated interpretations of financial results, in which failed attempts to manage upcoming crisis will cause increasing devastation in financial systems, in the form of immediate and large-scale consequences.

Stakeholders not only have access to financial information to be decoded; they have the existing interpretations of other actors. We propose a need for research on the importance of these interpretations—of the way market actors collectively make sense of accounting information. This sensemaking occurs in the emotion-laden, cognitive processes typical of impending financial crises, particularly with respect to the importance of financial reporting vis-à-vis information from other sources, such as rumors. Although nobody is able to control interpretations of either financial or nonfinancial reporting, it appears that researchers and practitioners place greater emphasis on nonfinancial reporting in their attempts to exert greater influence.

The stabilizing actions of regulators and their contributions to banks in financial crisis should be studied with respect to their roles as regulators and supervisors. There is a definite lack of knowledge about the way regulators and banks interact to stabilize supervised banks and to avoid the unintended consequences for the public, investors and creditors—avoiding the worry or fear that is often generated when it becomes known that a bank is being investigated.

Finally, comparative studies could be undertaken, comparing banks that have survived a financial crisis with their independence intact and banks that have been nationalized, merged or acquired as a consequence of poor communication. A study of bank officials’ preparations for financial crises would go a long way in furthering our understanding of the banking industry when concern turns to fear.

Notes

1. For the purposes of this study, we define a bank’s financial reporting as financial numbers such as mortgage assets, deposits, equity, income, expenses, profits and cash flows. A bank’s nonfinancial reporting refers here to explanatory text about the bank by its management through the financial statement and other financial reports, explanations about the numbers and formal announcements such as NR press releases explaining events and relating them to current and future financial numbers.

2. Shin (2009) argued that because NR was dependent on short-term funding to finance its long-term lending, NR’s balance sheet was fragile. Similarly, the House of Commons Treasury Committee (2008, p. 3) concluded that NR’s business model was “reckless.” Neither of these analyses explains why the bank run was triggered when the liquidity of NR was finally guaranteed by Bank of England, the ultimate guarantor. Other studies of NR have focused on the governance of banks (see e.g. Branston et al., 2012; Linsley and Slack, 2013) or on shareholder investments when a bank is nationalized (Bholat et al., 2012). But none of the studies mentioned here have focused on the process of crisis communication and why it failed.

3. GfK is a company with operations in more than 100 countries, providing market and consumer information.


6. A swap is an agreement of exchange. In an interest rate swap, the parties change from a floating rate to a fixed rate or vice versa.

7. Although the Triparties did not discuss the funding problems on the interbank market in public, there were signs of looming problems. The interbank market froze when BNP Paribas closed three funds that had invested in US subprime mortgages assets on August 9, 2007, forcing financial institutions to experience funding problems (Shin, 2009). Furthermore, subprime was identified as a problem on July 20, 2007, when BBC stated: Federal Reserve warns of credit losses of $100 billion due to subprime loans. Depositors, fund managers and analysts may have considered this warning of marginal significance, however, because, as Shin (2009) noted, NR had virtually no “subprime loans.”

References


**Further reading**


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Practice variation in Big-4 transparency reports

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Abstract

Purpose – The purpose of this paper is to examine the transparency reports published by the Big-4 public accounting firms in the UK, Germany and Denmark to understand the determinants of their content within the networks of big accounting firms.

Design/methodology/approach – The study draws on a qualitative research approach, in which the content of transparency reports is analyzed and semi-structured interviews are conducted with key people from the Big-4 firms who are responsible for developing the transparency reports.

Findings – The findings show that the content of transparency reports is inconsistent and the transparency reporting practice is not uniform within the Big-4 networks. Differences were found in the way in which the transparency reporting practices are coordinated globally by the respective central governing bodies of the Big-4. The content of the transparency reports is particularly influenced by the national institutional environment in which the Big-4 member firms operate, thus leading them to introduce practice variation and resulting in cross-national differences.

Practical implications – The study results have important implications for standard setters, regulators and practitioners, as the research provides insights into the variation taking place within the common regulatory frame.

Originality/value – This is the first study to analyze how transparency reporting practices are developed within the networks of Big-4 firms, thereby influencing the content of transparency reports.

Keywords Legitimacy, Institutional logics, Accounting firms, Cross-country difference, Practice variation, Transparency reports

Paper type Research paper

1. Introduction

Following the high-profile corporate scandals at the beginning of this century, and the recent financial crisis, audit quality has become one of the top-priority issues for regulators, standard setters, researchers and practitioners (Deumes et al., 2012). The discussion has included the assertion that increased transparency[1], with respect to governance and the professional practices of audit firms, may enable stakeholders and market participants to differentiate between firms, which, in turn, may provide accounting firms with incentives to increase their audit quality (International Organization of Securities Commissions, 2009). Providing greater transparency and disclosures will also enable interested parties to be better informed about how the firms are managed (Patel and Dallas, 2002). In line with this reasoning, the EU revised its Eighth Directive (European Parliament and Council of the European Union, 2006), requiring all public accounting firms in the EU that audit Public interest entities PIEs[2] to publish transparency reports disclosing information about the firms’ organization, governance and quality control with effect from 2008 (Pott et al., 2008). However, in spite of the increased transparency disclosures, and contrary to the EU’s intentions, public interest in these reports appears to be weak (CCAB, 2011). It is the overall purpose of this paper to contribute to an understanding of this paradox by analyzing the content of transparency reports and the process by which these are prepared. The regulations concerning transparency reports are found in the EU Eighth Directive’s Article 40 (European Parliament and Council of the European Union, 2006),
requiring all statutory auditors and public accounting firms in the EU that audit PIEs to disclose the following information:

1. a description of the legal structure and ownership;
2. whether the audit firm belongs to a network, a description of the network, and the legal and structural arrangements in the network;
3. a description of the governance structure of the audit firm;
4. a description of the internal quality control system of the audit firm and a statement by the administrative or management body on the effectiveness of its functioning;
5. an indication of when the last quality assurance review took place;
6. a list of public interest entities (PIEs) for which the audit firm has carried out statutory audits during the preceding financial year;
7. a statement concerning the audit firm’s independence practices which also confirms that an internal review of independence compliance has been conducted;
8. a statement on the policy followed by the audit firm concerning the continuing education of statutory auditors;
9. financial information showing the importance of the audit firm, such as the total turnover divided into fees from the statutory audit of annual and consolidated accounts, and fees charged for other assurance services, tax advisory services and other non-audit services; and
10. information concerning the basis for the partners’ remuneration.

As they appear, the directive’s requirements are quite broad and leave some discretion to member states in relation to the implementation of the directive into local law. Furthermore, local law may, in turn, allow accounting firms some discretion as to their interpretation in practice. Consequently, there is ample opportunity for various strategies in relation to the level of desired disclosure and the degree of coordination within and between firms and countries. However, knowledge about how the transparency reporting practices are set within the global networks is sparse. Important questions relate to the degree to which the global central governing body of the network or professional bodies coordinate the content of the reports, whether member firms seek legitimacy by imitating the transparency reporting practices of other accounting firms, or whether accounting firms tailor disclosures to the needs of specific stakeholders.

Accordingly, the research aims are to analyze the contents of Big-4 accounting firms’ transparency reports in the UK, Germany and Denmark, and to analyze the determinants of the content of transparency reports in Big-4 accounting firms in the UK, Germany and Denmark. The analysis examines two contradictory forces, which in theory may influence the content of transparency reports. On one hand, big accounting firms would be expected to produce consistent transparency reports cross-nationally because the Big-4 describe themselves as “one firm worldwide,” providing a consistently high-quality service (Arnold et al., 2009) and organized in highly integrated networks cross-nationally (Lenz and James, 2007) for their global clients and users. On the other hand, variation in the level of disclosure in transparency reports may be expected because tensions between institutions in the business, legal and cultural environments may lead local accounting firms to adapt the content of transparency reporting.

The remainder of the paper proceeds as follows. Section 2 reviews the existing research concerning transparency reporting and discusses the theoretical perspectives based on institutional theory and practice variation theory. Section 3 describes the qualitative
research design and explains the choice of the three countries to be studied: the UK, Germany and Denmark. In Section 4, the content of the transparency reports of the Big-4 firms in these countries is analyzed, supplemented by explanatory findings from interviews with the partners/directors/CFOs who were involved in formulating these reports. Finally, Section 5 presents the discussion, conclusion and implications for research and practice.

2. Theoretical perspective

The previous literature on transparency reports is very limited as the transparency reporting directive is relatively new. To date, scholars have examined only the perception of practitioners about the effectiveness of transparency reports and the relationship between the extent of variation of disclosures across firms within a country and the number of PIE clients (Pott et al., 2008; Petersen and Zvirner, 2009; Pheijffer, 2010; Pivac and Čular, 2012; Fu et al., 2015). The only notable exception is the study by Deumes et al. (2012) that examines whether there are cross-country variations in the disclosure levels and their relation to audit quality. Their study did not find any association between the number of disclosures and the audit quality and suggested that the cross-country (Austria, Germany, the Netherlands, the UK) differences may be driven by national regulatory requirements.

This study further examines the influence of the institutional environment of the Big-4 on the development of transparency reports by drawing on two main theoretical arguments: an argument as to why similar transparency reporting practices may be expected, and an argument as to why variation in transparency reporting may be expected.

The argument for expecting similar transparency reporting practices is based on neo-institutional theory, which has been widely used for studying the adoption and diffusion of organizational practices (DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Scott, 2001; Tolbert and Zucker, 1985). Organizations conform to the set of beliefs and integrated norms, practices and procedures imposed by the institutional environment (Powell and DiMaggio, 1991) to increase their survival prospects, legitimacy, political power and resources by conforming to societal expectations (Meyer and Rowan, 1977; Scott, 1987). DiMaggio and Powell (1983) theorize three type of isomorphism – coercive, mimetic and normative – that cause organizations to become increasingly similar. Coercive isomorphism relates to cultural expectations to adopt certain structural forms and/or practices, occasionally imposed by formal regulation or powerful authorities. In relation to transparency reporting, coercive pressure derives partly from the way in which Big-4 firms are organized and partly from the regulatory environment. Even though Big-4 firms remain independently owned and managed on a national basis (Lenz and James, 2007; Malhotra et al., 2006), the global central governing bodies of the Big-4 firms seek to organize and integrate the member firms by imposing common standards and practices imposed by the central governing bodies of the network (Zimmermann and Volckmer, 2012) to retain their membership of the network. Thus, the transparency reporting practice is likely to be coordinated by the respective central governing body of the Big-4 firm. These kinds of enforcements imposed by the central governing bodies of the accounting firms can be interpreted as coercive pressure to increase the homogenization in the transparency reporting practice across EU countries. Furthermore, a regulatory source of potential coercive pressure is the European Group of Auditors Oversight Bodies, replaced in 2016 by the Committee of European Auditing Oversight Bodies. This is a platform on which the public oversight bodies of accounting firms from different EU member states can interact and share their best practices to facilitate effective coordination and harmonization between fragmented national systems, thus creating pressure to conform to the common European practice. In addition to coercive
pressure, it may be expected that transparency reports are subject to mimetic isomorphism. Mimetic isomorphism refers to organizations adapting to uncertain or ambiguous expectations by mimicking the forms/structures of other organizations, which are considered to be successful and legitimate in their context. Since the transparency reporting directive is relatively new, member firms are likely to be uncertain about users' expectations. Therefore, member firms may also imitate the practices of other member firms from other countries to deal with uncertainty and ambiguity about the kind of disclosures that need to be published. Audit firms producing transparency reports may also be subject to normative isomorphism. Normative isomorphism exists where organizations adapt to the professional values and practices that are considered to be legitimate by society. Many EU endeavors are largely directed towards the establishment of a single market (Humphrey et al., 2011). To achieve that goal, there has also been increasing reliance by the EU on international professional bodies to bring homogeneity to the standards and practices of accounting firms (Loft et al., 2006). Thus, it may be expected that international bodies like FEE or IFAC play a role in exerting normative pressure by generating convergence in the transparency reporting practices of the accounting firms to maintain their legitimacy. Similarly, at the national level, the local professional bodies may act to harmonize the content of transparency reports to be considered legitimate by society. This legitimacy is of great importance because auditing's professional recognition is based on a social contract with society to work in the public interest in return for privileges like monopoly on statutory audits and self-regulation. Compliance with such a social contract is a precondition for legitimacy (Deegan et al., 2000; Deegan, 2002; Magness, 2006). While an individual audit firm's breaches of the social contract may be expected to lead the firm to manage disclosure to reinforce legitimacy, it is also likely to lead to responses to manage disclosure at the professional level if the public considers the breaches to represent a general practice that is not in accordance with the public interest. In turn, this is likely to lead to increased intensity of coercive pressure from regulators and/or increased normative pressure from professional bodies. Thus, according to the neo-institutional perspective, consistent and homogenized content may be expected in transparency reports within the respective network of large accounting firms.

The argument for expecting variation in transparency reporting practices is based on practice variation theory. This perspective focuses on actors, such as individuals or firms who are embedded in multiple institutional environments (Friedland and Alford, 1991; Lounsbury, 2008). This is the case with the networks of Big-4 firms, which have a complex institutional structure where member firms share not only the institutional environment of their international network and the profession, but also the national institutional environment of the country in which they operate, giving rise to institutional duality (Malhotra et al., 2006). Thus, the Big-4 can be described as pluralistic firms as they function in multiple institutional spheres and experience multiple regulatory regimes (Kraatz and Block, 2008). In these cases, institutional complexity may be experienced differently by the actors and therefore their responses are likely to vary (Greenwood et al., 2011). The characteristics of accounting firms in terms of structure, ownership, governance and identity, can make actors particularly sensitive to a certain logic and less so to others (Greenwood et al., 2011). Thus, an accounting firm's multiple embeddedness exposes actors to divergent pressures that stem from divergent institutional logics[3], which, in turn, enables variation in the actors' cognitive orientation (Kilfoyle and Richardson, 2011; Lounsbury, 2008; Lounsbury and Crumley, 2007; Modell and Wiesel, 2008). This is likely to result in practice variation in transparency reports. In general, practice variation that is perceived to fall within the boundaries of the existing institution is usually allowed to continue as a marginalized practice. This may well be the case when accounting firms make minor variations to manage legitimacy. However, if a practice variation is socially
recognized as an anomaly it will challenge extant institutions and will thus be likely to create resistance from the actors whose logic and interests are being challenged (Lounsbury and Crumley, 2007; Marquis and Lounsbury, 2007; Seo and Creed, 2002). To become broadly accepted, new practice variation therefore requires field level political negotiations about its appropriateness (Lounsbury and Crumley, 2007). The political aspect is further reinforced because changes in the level of transparency are, in themselves, likely to affect power relations between the actors involved (Meijer, 2013). Consequently, in case of material variation in transparency reporting practices, we expect to find negotiations within the auditing profession and between accounting firms and stakeholders about the appropriateness of this variation.

In summary, an accounting firm’s development of transparency reports may be subject to pressures making transparency reporting more homogeneous as well as pressures that may make it more heterogeneous. Coercive, normative, and mimetic pressures push transparency reporting practices to become more homogeneous within the accounting firms’ networks. Problems relating to auditing’s social contract to work in the public interest may be expected to increase the intensity of the coercive pressure from regulators and the normative pressure from professional bodies. Mimetic pressure may relate to the practices of other accounting firms in the domestic market as well as to the practices in the accounting firm’s international network, thus pushing transparency reporting to become either more homogeneous at the national level or within the international network of accounting firm. Accordingly, the embeddedness of Big-4 accounting firms in multiple organizational fields may give rise to divergent institutional pressures or conflicting logics. This can further intensify based on the characteristics of the firm, for example, the degree of centralization and control. Divergent pressures are likely to lead the accounting firm to adapt its transparency reporting, thus creating variation in the content of transparency reports. Consequently, the analysis of an accounting firm’s transparency reporting practices needs to focus carefully on the context of the particular accounting firm and on its characteristics.

3. Research design and methodology

Due to a lack of sufficient explanation in the earlier literature as to why there may or may not be cross-national variations in transparency reporting practices, a qualitative research approach is deployed to fill this gap. The qualitative approach is adopted due to the nature and context of the study as it is particularly relevant when there is a need to better understand any phenomenon about which prior insights are modest (Ghauri and Gronhaug, 2005, Strauss and Corbin, 1990). The qualitative research approach is more concerned with understanding the reality from an actor’s perspectives, how these perspectives are shaped by, and how they shape their physical, cultural and social contexts, and which particular processes are involved in preserving and altering these phenomena (Firestone, 1987; Maxwell, 2012). The greatest benefit of a qualitative study is that it not only describes a specific event but also deepens our understanding of how and why the “same” event is interpreted in a different manner by different stakeholders (Sofaer, 1999). This aspect provides significant value in studies of policy making, implementation and outcomes (Sofaer, 1999). Accordingly, this study also involves the revised Eighth EU Directive; the qualitative approach will enlighten our knowledge of how EU directives are being implemented in the Big-4 public accounting firms operating in the EU.

The UK, Germany and Denmark were selected for this study. This choice of countries was based on considerations regarding the diversity of the legal systems, providers of corporate capital, and protection rights for investors. The UK is characterized as a common law country having stronger laws for the protection of outside investors with a large equity market and dispersed ownership structure (Van Tendeloo and Vanstraelen, 2008), whereas Germany is a code law country and provides higher protection laws to creditors due to the
presence of a large bank and pension fund oriented capital market, among whom the ownership and voting rights are generally concentrated (Frost and Ramin, 1996). Denmark belongs to a different sub-type of civil law system: it is of a more pragmatic Scandinavian type and, due to the presence of family business models, the ownership is highly concentrated and voting rights are vested with the insiders. Denmark has low protection rights for outside investors and is considered to have a more concentrated ownership structure (La Porta et al., 2000). Thus, the selected countries provide a fair representation of the regulatory diversity within the EU and therefore enable an assessment of the degree to which transparency reporting practices are affected by regulatory traditions. The study is based on transparency reports that were available online for the Big-4 audit firms. It is confined to the reports for the year 2012 as, by law, audit firms are allowed to remove the reports from their website two years after publication. The structure of the reports follows the prescribed directive requirements listed in the introduction.

This study was carried out in two stages. Content analysis was used in the first stage of the study, where the central idea was to classify many of the words into fewer content categories and to make valid inferences from the text (Weber, 1990) by systematically classifying the process of coding and identifying themes and patterns (Hsieh and Shannon, 2005). The content analysis facilitated comparisons of the transparency reports across three countries. First, the transparency reports were gathered for the year 2012 for all Big-4s in the UK, Germany and Denmark and the reported disclosures for each audit firm were then systematically arranged into nine categories. The coding categories were broadly obtained from the EU Eighth Directive, which lays down the list of disclosures that audit firms must include in their transparency reports. Additional sub-coding categories were identified based on common themes. The disclosures in all 12 transparency reports were then manually read and recorded against the coding categories in order to obtain cross-country comparisons. By performing multiple iterations, the final level of analysis was reached that identified the kinds of differences that exist between the Big-4’s transparency reports in the UK, Germany and Denmark. The length of each report systematically varied from country to country (cf. Table I).

The next stage in the study entailed conducting semi-structured interviews with the key people at the top of the firms who were involved in developing the transparency reports of the Big-4s. Most of the informants were national risk management partners, directors and CFOs. The objectives of the interviews were to gain an understanding of the participants’ perspectives on how transparency reports are prepared and what considerations they took into account when preparing these reports. A semi-structured approach facilitates an open-ended and flexible nature in the interview design and conduct, providing a richer data set for later analysis (Horton et al., 2004). This approach enables spontaneous discussions and follow-up on questions (Lee, 1999) and allows respondents to freely express their thoughts and ideas. To gain insights into the process of preparing the transparency reports and the key challenges encountered while doing so,
purposeful sampling was applied, only interviewing informants who were responsible for making key decisions on the reports. A total of 14 interviews were conducted, of which 13 were face-to-face interview and one interview was mailed to the lawyer in a legal department. Interviews were conducted with key people in all Big-4 companies in each of the three countries, with the exception of company ZZZ in the UK because the partner was unavailable due to his busy schedule. Interviews were also conducted with members of the oversight bodies[5] from all the three countries. This was undertaken to develop an understanding of how the transparency reports are examined and perceived by these bodies. See details of interviewees in Table II.

All the interviews were conducted in English between November 2013 and July 2016. The average length of each interview was 40 minutes. In order to increase the trustworthiness of the collected data, various measures were taken. First, an interview guide was used to ensure that there was a consistent framework across all countries, and that questions did not vary significantly from one interview to another. Second, before the interview began all interviewees were given an assurance of confidentiality and anonymity to encourage candid responses. Third, the respondents’ permission to tape-record the interviews was requested. To establish rapport with the interviewees, an e-mail containing background information about the research, the researcher and the assurance of anonymity and confidentiality was provided and interviewees’ questions related to the study were addressed before the interviews were scheduled. All but one of the interviews were tape-recorded and subsequently transcribed. In one case, the respondent did not want to be recorded, here hand-written notes were taken both during and after the interview. All the transcribed/notes of the interviews and other material were systematically examined multiple times manually. The relevant data were divided into clusters and the emergent themes and their relationships were identified through recurring patterns with respect to the theoretical perspectives that were used to address the research questions (Scapens, 2004). The themes that emerged in the study thus served as answers to the research question. To reduce the researcher bias the data was also reviewed by both authors to arrive at a similar interpretation.

4. Findings
This section presents the main findings and discusses them in light of the previously reviewed literature. The aim of the study was to examine the contents of the transparency reports

<table>
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<tr>
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</tr>
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<td>B</td>
<td>AAA Germany</td>
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<tr>
<td>C</td>
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<tr>
<td>F</td>
<td>YYY UK</td>
<td>Partner risk management</td>
</tr>
<tr>
<td>G, H</td>
<td>YYY Germany</td>
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</tr>
<tr>
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</tr>
<tr>
<td>J</td>
<td>XXX UK</td>
<td>Senior manager</td>
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<tr>
<td>K</td>
<td>XXX Germany</td>
<td>Lawyer – legal department</td>
</tr>
<tr>
<td>L</td>
<td>XXX Denmark</td>
<td>CFO</td>
</tr>
<tr>
<td>M</td>
<td>Regulator – UK</td>
<td>Member of audit inspection oversight body</td>
</tr>
<tr>
<td>N, O</td>
<td>Regulator – Germany</td>
<td>Members of audit inspection oversight body</td>
</tr>
<tr>
<td>P</td>
<td>Regulator – Denmark</td>
<td>Member of audit inspection oversight body</td>
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Table II. Details of interviewees
reports of big accounting firms and to develop an understanding of what determines the content of the reports within the network of the Big-4s. On the basis of the content analysis, it is concluded that the content of transparency reports is inconsistent within the Big-4 networks, and that transparency reporting practice is not uniform across the network. Differences were found in the way in which transparency reporting practices are coordinated globally by the respective central governing bodies of the Big-4s as well the regulators. Only two of the four large accounting firms were tightly controlled and had global guidelines on transparency reports prescribed by their central governing bodies, the aim of which was to maintain uniformity of disclosures. The other two firms allowed their member firms to develop their transparency reports at a national level. In both the scenarios the member firms tended to become more isomorphic in the national institutional environment of the country from where they operate. One of the prime reasons behind national isomorphism was the use of the transparency reports. All respondents from the Big-4s unanimously agreed that the local oversight body and the competitors are, potentially, the main readers of the transparency reports. As noted by one of the directors on being asked about the usage of the reports:

It goes to the professional oversight board or the regulator and we know that the inspection team reads it very carefully […] I cannot really think of a situation where we benefitted from it. There has been no feedback on the content of it. I do not think people use it as a differentiator (Director, ZZZ Big-4, UK).

Another German partner at ZZZ substantiated the above view:

Usage of this is very limited. In the beginning we did an analysis and found out that most of the readers are academics or competitors. It was quite disappointing. No one else is interested in it. It’s form over substance rather than substance over form […] clients are not interested (Partner, ZZZ Big-4, Germany).

Similarly, the oversight bodies were not quite sure how widely the reports are being used by the market, but all of them indicated that it has limited usage due to the information contained in the report. An illustrative comment was:

I don’t have a sense of how widely read these things are. At the end of the day what you have to remember is that the firms produce an awful lot of reports. If you take their (Big-4’s) annual reports, they are not slim documents, they are quite thick and the transparency report is going the same way. They are glossy documents […] There is an awful lot of information out there. There is a lot of reporting and people only have a finite time and therefore they focus on the things that they think are most useful to them, they cannot read everything out there (Member of oversight body, UK).

The oversight body in Germany also indicated why the transparency reports might not be too helpful to the market:

So far one source of information about auditors is transparency reports so I don’t know if you have done this so far talking to the audit chairs but the answer might be that what is in the transparency report we already know, maybe not each and every aspect, but for doing the evaluation of the audit firm it doesn’t really give more additional information (Member of oversight body, Germany).

As the users of the report are primarily the national oversight bodies and competitors, and if the member firms feel any uncertainty about the market expectations with respect to disclosures, they tend to follow what the other member firms are disclosing in the national market and do not refer to the reports of international member firms. All the participants stated the view that they read the reports of their competitors in the national market. On being asked if the member firm follows the reported content in their international network, all participants said that their point of main reference was other national Big-4s
and, due to different style of reporting and regulations, they rarely refer to the other member firms in their own international network. A representative comment was:

“It’s really not something that’s very much discussed internationally [...]. We don’t look at what they do in the UK or Germany anyhow, where should we start and where should we stop, and we really don’t feel that there are users in the UK or Germany or we don’t compare with them at all in the day-to-day market. We don’t really see the relevance (Director, YYY Big-4, Denmark).

This study found significant support for the mimetic pressures prevailing at the local level that member firms use to benchmark their own transparency reports against those of their local competitors. Member firms closely follow the reports issued by their competitors and analyze the level of disclosures in the local market. Member firms mainly observe the style, layout, and structure of the reports and the level of sensitive disclosures made by their competitors. For example, this may include claims or sanctions against the audit firms for delivering a poor audit quality, and details of partners’ remuneration. The practice of following the local member firms was confirmed by one of the participant’s whose view was representative of all respondents:

I would say that the level of transparency is driven by the local market, no doubt about that. The challenge is to agree on what the level of disclosure should be. Very often we want to disclose more but you end up pulling back because you say: OK, no one else does this then why should we stick our heads further out than everybody else (Director, YYY Big-4, Denmark).

Interviewees from oversight bodies also mentioned the view that mimetic pressures exist at the local level. A representative comment is illustrated below:

I think everyone (Big-4s) is looking at each other and if one company starts to reduce the other one will follow, and vice versa. No one will give more information than their competitors. So, if someone is looking to reduce the information I think it has big influence on other companies (Member of oversight body, Denmark).

It is the expectations of the national institutional environment that play a significant role and exert pressures on the national member firms to adopt similar practices. Thus, it can be inferred that the member firms attempt to gain legitimacy in their national institutional environment by conforming to the expectations of the national market and the result is that they become isomorphic with each other. As can be seen in Table III, it was also the case that although all the firms provide a general overview of the partners’ remuneration, it is only in Germany that all firms consistently mention the percentage of average remunerations of fixed salaries paid to the partners/directors. One of the respondents explained the pressure from the competitors that they had to face in the domestic market:

The only area where we keep to the required minimum is the remuneration. We were actually criticized by our competitors in our first report in 2008 or so, and now we say: “OK, the flexible part of remuneration for directors is x% on average of the fixed salary”. That’s it. So, when we started, this was difficult at first (Partner, ZZZ Big-4, Germany).

The regulators’ intention in introducing partners’ remuneration in transparency reports might be to address concerns about auditors’ independence. The auditors have an economic incentive to sell non-audit services as these are usually considered to be more profitable, thereby creating a threat to their independence (Tepalagul and Lin, 2015). The table shows that almost all firms describe the process, measures and components of partners’ remuneration but no firm describes how much weight is given to each criterion. From the transparency reporting perspective, this also raises concerns about the informational value of the disclosures.

One respondent made an interesting comment that firms are maintaining limited transparency with respect to remuneration:

Everybody kind of says that our remuneration is not based on selling other kind of services. But [...] of course if you have sold a lot of those services, because everybody promotes it,
<table>
<thead>
<tr>
<th>Remuneration details</th>
<th>PWC</th>
<th>Deloitte</th>
<th>UK</th>
<th>E&amp;Y</th>
<th>PWC</th>
<th>Deloitte</th>
<th>Germany</th>
<th>E&amp;Y</th>
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<td>Yes</td>
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</table>

Table III. Partner remuneration
everybody is supposed to do it. If you have sold one million of tax advice to your audit client, you get 10% of that. There is no direct link but if you expanded the business of your clients then that you would get a higher score on your balanced scorecard. Of course there is some kind of relation. You cannot say that there is no relation. That is not true. So, it is a very sensitive area to be disclosed in reports (Director, YYY Big-4, Denmark).

Based on the remuneration information provided in the transparency reports, this may not only be difficult for the external users to assess how partners are remunerated but may also pose a challenge for the oversight bodies. This view regarding remuneration was verified during the interview with the German oversight body:

The requirement when it comes to remuneration is a critical thing. In some instances we saw it was a little bit too vague in the TR or we think the wording is quite proper but how they (Big-4s) are doing the process and splitting the money among the partners we cannot really see whether they follow their own procedures. Sometimes the situation comes in where they follow the systems and procedures that are established for the allocation and we see some documentation where one partner is evaluated properly, like the other one, but yet one partner gets double the amount of money [...]. It is a hot topic that we look at because firms do not want to give too much information (Member of oversight body, Germany).

Another critical factor causing practice variation was cross-national differences between domestic oversight bodies. In all the interviews, respondents also highlighted the dominant role played by the national oversight body in shaping the transparency reports of the Big-4 public accounting firms. It has been documented in the literature that the UK is classified as one of the strictest countries in Europe in terms of legislation that ensures a high audit quality regime (Moizer and Turley, 1989). The results of this study support this finding. The British oversight body was found to have a stricter approach than the German and Danish oversight bodies with respect to the reported content in transparency reports. For example, as seen in Tables IV and V, in the UK, all the firms focus on a high level of detail of their global governance structure, legal structure and national line governance structure, in contrast to the German and Danish member firms. This is because the audit firm governance code in the UK requires that in their transparency reports all Big-4 accounting firms to supply information on names and job titles of all members of the firm’s governance structures and its management team, how they are elected or appointed their term of appointment, length of service, meeting attendance in the year and relevant biographical details. Other countries do not have such governance codes, so this creates cross-national differences in the reports.

It can be clearly seen from Tables IV and V that the more tightly controlled firms (KPMG and EY) attempt to maintain consistency in their disclosure practice with respect to their governance structure across all three countries; in contrast to the more loosely controlled firms (PWC and Deloitte). The description style of ownership structure seems to be unique, particularly in UK and Germany. The British firms describe the ownership structure in detail whereas firms in Germany provide the share capital owned by German member firms. With the exception of one firm in Denmark, the UK is the only country where all firms provide information about the number of partners, which implies that these kinds of disclosures are allowed to continue as a marginalized practice at the local level since the practice does not challenge the logics and interests of the other firms. The lists of numbers of offices of the firms are also found only in British and German reports.

Similarly, Table VI (Panels A and B) also illustrates the differences in the regulatory requirements of the three countries. In general, the regulators’ purpose in requiring the financial information disclosure related to audit and non-audit services is to provide users with information to evaluate whether the proportion of the generated revenues causes them to question independence. The financial information could also be used to understand the focus of the audit firm with respect to the kinds of services provided. Since, it is mandatory to publish the revenues and the operating profits and to have a Public Interest Committee
Table IV. Global Governance Structure Details

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<tr>
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<th>UK</th>
<th>PWC</th>
<th>Deloitte</th>
<th>KPMG</th>
<th>E&amp;Y</th>
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Table IV.
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<td>KPMG Europe structure and web link provided for KPMG Europe LLP</td>
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(PIC) in the UK, therefore three out of four firms disclose not only the revenues generated from audit and non-audit services, but also their operating profits and the reports from the PIC, in contrast to Germany and Denmark.

Differences are also found between regulatory styles. The British oversight body believes in encouraging UK member firms to be more open and transparent. They perceive transparency reports as a firm’s opportunity to differentiate itself from other firms, as described by one participant:

In the past, YYY went to speak to the regulators and after the first year, regulators made the observation that it was hard to differentiate between the big fours. Regulators were pushing us to be different and to be more transparent as it looked too generic. Regulators were encouraging us to think about additional disclosure (Partner, YYY Big-4, UK).

The British oversight body also commented the same:

What I have done in the past is I have compared the transparency reports that are published against the requirements and then looked to see whether firms go over and above that. What additional information the firms decide to give, and the other thing we are looking at is to see, from our point of view we regard the transparency report as firm’s opportunity to differentiate itself from another firm. The danger of saying this is the minimum and then effectively you get a boilerplate. So, everyone has got a template and you just insert your own bit and then it is very difficult for the user to actually say what the actual differences are between these firms or is it actually relevant which firm I picked to do my audit if they all appear the same. So, those are the sorts of comments that we try to make in our inspection report. We try and highlight who perhaps has made a good disclosure (Member of oversight body, UK).

The above statement also indicates that, in contrast to Germany, the British oversight body tries to establish the best practice in the local market. On being asked about how the German oversight body tries to encourage firms to disclose more, one representative of the body replied:

I think we do not have a mandate to motivate them for any best practice because our task as a state authority is to do a compliance check. So, even if we consider one transparency report to be better than another, it is not our role to enforce any best practice. If the transparency report fulfills the...
requirements of article 13, and we don’t see a different reality in the inspection, even if there could be nicer wording or more content, then we could say that we are done (Member of oversight body, Germany).

Similarly, Denmark was found to be a late starter and, until 2013, there was no independent state audit oversight body evaluating the transparency reports of the Danish audit firms. During one of the interviews a Danish partner stated:

We have a new regulator. For the first time inspections are carried out by people from the state […] But realizing that the non-existence of an inspection unit was not in compliance with EU directives, Denmark received a warning that if we didn’t change and created a public inspection unit, we would have a case against us by the EU, and since we are usually good EU citizens we immediately formed a state inspection unit (Partner, ZZZ Big-4, Denmark).

The role of inspection by an independent audit oversight body unit is critical in influencing the content of the reports. According to the regulation from the EU, Article 26 (European Parliament & Council of the European Union, 2014), the third prime objective of state inspection is to assess the contents of the transparency reports of accounting firms. The British oversight body is likely to be ahead of the other oversight bodies in this respect because they were established early. The British system of regulation is more open and transparent as it makes audit inspection findings publicly available for each large accounting firm. In comparison to this, in Germany it is forbidden by law to make the inspection results public. The audit inspection report findings in the UK not only reveal the audit quality review outcomes of the firm but also highlight the assessment of how informative the disclosures are in the transparency reports. By making these outcomes public, the British oversight body incentivizes firms to disclose these outcomes in their transparency reports and to promote the quality of reporting and auditing. The oversight body ensures that consistency is maintained among the firms in terms of the reported content in their annual report as well as the transparency report. It also publishes a combined inspection report on the contents of the transparency reports produced by auditors of PIEs. The oversight body aims to establish best practice with respect to transparency reports by highlighting the names of the firms that publish good, relevant disclosures and the firms that are not meeting the expected benchmark as defined by the British oversight body:

From the firms’ point of view, in the audit quality inspection report particularly they (Big-4s) are named or they are not named as a good example. They see that as potentially embarrassing because all the firms want to be seen as best. So, by not naming them they almost feel publicly shamed, or if we say someone has been a particularly bad example or someone has failed to publish something that they should have done, then it’s quietly damming on the firm because, particularly the big firms, see themselves as the market leaders and see everyone else trying to follow them (Member of oversight body, UK).

However, no such requirement of making the results public was found in Germany or Denmark. The results are published on an anonymous basis without naming any firm, as the following extract from an interview with a Partner from AAA in Germany shows:

Interviewer: Do you have interactions with your regulator with respect to transparency reports?

Partner: Not at all, unless we are not in compliance with the law or if they (regulators) have different views on what needs to be in the report.

Interviewer: Do regulators come back to you?

Partner: No, we just describe the facts. The regulators have the annual inspection of PIE clients anyway. They just check whether the contents of transparency reports are aligned with what is required by the law.
Interviewer: Why are inspection findings not disclosed in your transparency reports?

Partner: Because it’s not required by the law. It is not required by the directive. So why should we do so when we are not required to do so? This is a cultural thing, who cares about this? This is just imposed by law and adds no value at all […]. Regulators have their findings as well but currently these findings are not published, but there is a confidentiality rule. It’s not allowed. They cannot do it.

The above quotes reflect how differences in the power relation between the state and the accounting profession in each country lead to differences in regulatory style, which in turn leads to practice variation between countries. German and Danish regulators only ensure that the firms are in compliance with the law, in contrast to the British regulators who aim to promote transparency by encouraging audit firms to publish more disclosures. The Danish regulator made an illustrative comment:

From a political point of view, Denmark is following the minimum implementation rule from the EU. Our government is giving high priority to situations or other rules from the EU, whose implementation makes sense from a local perspective. This is then considered but, as a rule, we are driving a minimum implementation. (Member of oversight body, Denmark).

Accordingly, Table VII shows that it is only the British firms that include the quality review outcomes in their transparency reports as these results are also publicly available on FRC’s website, in contrast to other countries where these results are perceived to be a matter of confidentiality. This is also an example of how national coercive and mimetic pressures shape the content of transparency reports. In Germany and Denmark, there is no pressure on member firms from regulators or oversight bodies to publish quality reviews, nor have any of the firms attempted to establish a market practice by making the results public. Therefore, it can be inferred that coercive and mimetic pressures exerted at the national level drive practice variation between countries.

However, the network of Big-4s has a complex institutional structure (Malhotra et al., 2006), where the member firms share not only the national institutional environment of the country in which they operate, but also the institutional environment of the international network to which they belong, thus giving rise to institutional duality. By prescribing transparency reporting guidelines to the member firms the global governing bodies of the two Big-4 firms try to exert coercive pressure (DiMaggio and Powell, 1983) over their member firms to comply with standard reporting practices in order to bring more consistency to the network. Consequently, due to the membership of this network, the Big-4 member firms attempt to adopt the globally prescribed transparency reporting guidelines. As stated by a Partner from ZZZ:

Yes, if I deviate from the global description, it needs to be reviewed, it needs to have a reason and, obviously, the standard reason would be the local legal requirements […]. But we are doing a lot to ensure and uphold consistency at the global level (Partner, ZZZ, Big-4, Denmark).

This multiple embeddedness in heterogeneous organizational fields may create divergent institutional pressures, specifically on those firms that are tightly controlled and

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Table VII. Quality review outcomes
coordinated by the central governing body of the Big-4s. A partner in a German firm that belongs to a tightly controlled network illustrated this:

Well, one of the things to overcome internally, I mean one of them I remember, is, as I said, we are not allowed to deviate from the global template unless it is required by German law. One thing we discuss almost every year is the issue that relates to the results of the internal quality reviews. German companies, including other Big-4s, do not publish or do not say anything about the results of the internal quality reviews. Our global template requires us to do so and we always have tough discussions with the global body because, so far, we have not published quality review outcomes. (Partner, XXX Big-4, Germany).

These results are in line with previous literature that shows that the organization fields are comprised of multiple competing logics and organizations manage to develop different sets of practices based on the dominant logic (Lounsbury, 2007). The above quote indicates, for example, that public reporting of quality review outcomes falls outside the boundaries of the existing German institutional practices and does not get recognized by the other firms in the German market. Thus, it is evident that the conflicting institutional pressures, from different directions, for tightly controlled firms can sometimes lead member firms to depart from their global transparency reporting practice. In this case, the more dominant logic for German member firms is to maintain legitimacy by conforming to the expectations of the national institutional environment and not publishing the quality review outcomes.

In summary, it is evident that for tightly controlled firms even though the imposed global reporting systems become a part of the member firms’ reporting system, the elements of practice variation are introduced by adapting to the national institutional environment as it enables member firms to strike a balance between multiple competing institutional logics. The global transparency reporting practice of member firms that belong to a tightly controlled network is adapted and transformed according to the national market expectations. The member firms become more homogenous in the national market and more heterogeneous in their international network. For firms that are loosely controlled, transparency reporting practices are allowed to be developed based on the national market logic. Thus, in order to gain legitimacy, member firms attempt to become more homogeneous in the national market by adopting or developing practices according to the national institutional demands. Consequently, cross-national differences in regulatory style, structure and governance of member firms, and limited usage of reports, contribute to explain the rationale for practice variation between countries.

5. Discussion and conclusion
The primary aim of this paper was to examine the transparency reports published by the Big-4 public accounting firms in the UK, Germany and Denmark in order to understand what determines the content of transparency reports within the network of large accounting firms.

Based on neo-institutional and practice variation theory, the study finds that the contents of transparency reports are particularly influenced by two factors; the degree of control within the firm’s international network, and the demands of the national institutional environment in which the member firm operates. All firms monitor the transparency reporting activities of their competitors in the local market, which create mimetic and coercive pressures to follow a local market logic based on local regulatory style. For the loosely controlled member firms, this is the main explanation for the development of their transparency reporting. However, the more tightly controlled member firms are also subject to coordinated global reporting requirements in their international network. This multiple embeddedness sometimes creates divergent institutional pressures, which in turn leads to practice variation in elements of their transparency reporting and indicates the audit firms’
preferences to maintain external legitimacy in the local market over international legitimacy. However, it might be possible that the tightly controlled international networks become carriers of institutions (Scott, 2003) that diffuse international practices in their national market. In theory, these practices may in turn become models of mimetic imitation for the more loosely controlled firms, but the study found no evidence of this.

Two noteworthy findings in the study are the importance of the national audit oversight bodies and the absence of professional bodies in the development of transparency reporting practice. Although transparency reporting was originally introduced as a consequence of problems in relation to the auditing profession’s social contract with society, the study did not find any evidence of normative pressures from local or international professional bodies like FEE or IFAC to manage transparency disclosures to reinforce public impressions of legitimacy. This may be because the public interest is formally represented in the national audit oversight bodies. Since successful representation is based on the silence of the represented groups (Callon, 1986), oversight bodies in countries with a critical public voice regarding audit quality such as the UK (see e.g. Sikka, 2009) may have had incentives to require more disclosure than actually needed to be on the safe side. Accordingly, the UK oversight body define transparency as imposing and encouraging additional stringent requirements above the minimum legal requirement, whereas in Germany and Denmark transparency is defined merely as complying with the minimum legal requirements.

However, in spite of the efforts placed on transparency reporting by audit firms, the usage of transparency reports is perceived to be very limited by auditors and regulators. This finding raises the question of why transparency reporting is required and/or allowed to continue in a way that does not create public interest. To discuss the explanations for this we draw on Meijer’s (2013) suggestion that transparency may be analyzed from a strategic, a cognitive, and an institutional perspective.

The strategic perspective focuses on how transparency arrangements affect power relations. Powerful groups have an interest in maintaining institutionalized power relations and are therefore likely to resist new transparency arrangements that give other groups access to new information because this may transfer power to these groups. From this perspective, the EU’s requirement that accounting firms report on transparency is thus an exercise of power over the international accounting firms. Transparency reports are rituals that demonstrate the EU’s sovereignty and enforce the accounting firms’ obedience, and may thus be seen as one element in the ongoing debate between the EU and the international accounting profession about the power to regulate accounting and auditing (see e.g. Humphrey et al., 2011). Therefore, it matters little whether the reports are used by the public, and accounting firms are allowed a certain degree of discretion when it comes to the actual content, which may explain the variation found in this study. However, even with the limited use of the transparency reports, they still have a disciplinary effect as, to some extent, accounting firms act as if the reports are used when deciding what content to disclose. While it may be expected that such a disciplinary effect would lead the accounting firms to resist transparency reporting, the study did not find evidence of this. The likely reason for this is that the accounting firms also benefit strategically from transparency reporting. As Power (1994) argued, public disclosure may have a pacifying effect by convincing the public that something is being done about its concerns over independence and audit quality, thus deterring further inquiry into these issues.

The cognitive perspective is focused on how cognitive frames are influenced by or influence transparency arrangements. Analyzing the relationship between transparency and trust, Grimmeilkhuijisen and Meijer (2012) found no effects of transparency on trust when users of information had high knowledge of the issue or a high general predisposition to trust. However, increased transparency did result in a rise in the degree of trust when users had little prior knowledge and a low level of general trust. These results are
interesting in relation to accounting firms because the implication is that transparency reports are not likely to influence the trust of users that are well informed about auditing or already trust auditors. Although the relationship between transparency reports and trust in accounting firms was not the object of this study, the views of the oversight bodies reported here indirectly support this view. As in the case highlighted by Grimmelikhuijsen & Meijer, accounting firms’ transparency seem to function as a “hygiene factor”: lack of transparency may generate distrust, a certain level of transparency is needed to create trust, but beyond this level more transparency does not create more trust. The findings of this study indicate that the necessary minimum level of transparency is already achieved by other means, such as the annual reports of the accounting firms that cover some of the disclosure also included in the transparency reports. Consequently, due to the limited response from the users of the report, the majority of audit firms do not consider it worth investing their time and resources in extensively developing the report by including rich information.

The institutional perspective is focused on how institutional rules are influenced by or influence new forms of transparency, for example, in the form of the intensive use of internet-based information. The choice of media directly influences two central dimensions of transparency: timeliness and comprehensibility (Grimmelikhuijsen and Meijer, 2012). Regarding timeliness, it is interesting to note that the media chosen to promote accounting firm’s transparency is copied from the old and well known annual financial report, which has long been criticized for not being timely and, consequently, it has been suggested that it should be replaced with internet-based access to real time information (Elliott, 2002; Wallman, 1997). Thus, any stakeholder interested in timely information about audit firms is forced to look elsewhere for the information. The choice of an un-timely form of report may indicate that the strategic perspective has been more important to the EU’s decision to require transparency reporting than the institutional perspective. The finding that audit oversight bodies are the primary users of transparency reports supports this. Similarly, the comprehensibility of transparency reports is not likely to be an issue for the present expert users of transparency reports, while in the strategic perspective it is not an issue at all.

Although there are potential reasons for the lack of public interest in transparency reporting, future research is needed to explore these. The focus of this study was limited to the perspectives of the Big-4’s and the oversight bodies in regard to transparency reports. Future studies may also undertake a comprehensive view of clients and other stakeholders in assessing the view of transparency reports, particularly the question of why ordinary users of audit reports show little interest in them. In such studies a focus on the perceived relevance, timeliness and comprehensibility of transparency reports may help in assessing the extent to which they actually provide transparency on the performance of audit firms, which is a precondition for the reports to raise audit quality. Transparency may also be a precondition for trust, and future research may address the effects of transparency reporting on trust in audit firms or auditors.

Despite these limitations, this study has provided insights into the way in which the Big-4 accounting firms operate. It is a noteworthy finding that the networks of the Big-4 are not identical and that practices vary within these networks. This finding calls for a nuanced approach in future studies of the Big-4’s organization and practices. It also questions the degree to which harmonization of auditing practices can be achieved by harmonized audit regulation alone. With differences between national adaptation of EU regulations, differences in the degree of control in the network, and differences in the preferences of the oversight bodies, practices will inevitably vary between countries. It is this ability to adapt transparency reporting practices to stakeholders’ needs that is likely to determine the future of transparency reporting. As suggested by the findings, this may be achieved by the audit firms developing transparency reports as marketing tools to influence audit committees. It may also be achieved by the oversight bodies requiring disclosure practices that will turn
transparency reports into instruments to demonstrate audit quality differentiation in order to promote competition in the audit market. However, if the reports remain a ritualistic exercise of power that is of no interest to a wider public, their future is questionable.

Notes

1. Transparency may be defined as “the availability of information about an organization or actor allowing external actors to monitor the internal workings or performance of that organization” (Grimmelikhuijsen and Meijer, 2012, p. 139).

2. Public interest entities are defined in the EU Eighth Directive as listed companies, credit institutions, insurance undertakings, and other designated entities. There is some variation between member states as to which entities belong to the latter group (FEE, 2014).

3. Institutional logics are defined as the organizing principles that affect cognition and guide decision making in a field (Friedland and Alford, 1991). In previous research, examples of divergent institutional logics that lead to practice variation are contradictions between efficiency logics and local community logics in banking (Marquis and Lounsbury, 2007); between a multinational company’s standard operating procedures and a sub-unit’s internal logics (Lukka, 2007); between global and local management control logics (Cruz et al., 2009); between efficiency logics and customer-oriented logics in performance management practices (Modell and Wiesel, 2008); and between public administrative and professional accounting logics in the development of public sector internal auditing (Arena and Jeppesen, 2016). Furthermore, in auditing there appears to exist a contradiction between professional and commercial logics (Zeff, 1987, 2003a, b; Hanlon, 1996).

4. For some of the firms, we compared 2011 reports against 2012 reports due to the unavailability of all reports for the year 2012, as the financial/accounting year varies from firm to firm. Furthermore, by law, audit firms are allowed to remove the reports from their website two years after publication.

5. In the UK the Financial Reporting Council (FRC), in Germany the Abschlussprüferaufsichtskommission, and in Denmark Revisorstilsynet.

References


Further reading


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Accrual management as an indication of money laundering through legally registered Mafia firms in Italy

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Abstract

Purpose – The purpose of this paper is to investigate how accounting is used to disguise and carry out money laundering activities in specific socio-economic and political contexts and whether discretionary accruals can provide evidence of such illicit practices performed through legally registered Mafia firms (LMFs).
Design/methodology/approach – The study is based on a sample of 224 Italian firms identified as LMFs, due to having been confiscated by judicial authorities because of their owners being accused of Mafia-type association. Using a multivariate regression model, specifically developed discretionary accrual proxies for LMFs are compared with those of a population of lawful firms (LWFs).
Findings – The results reveal that in the pre-confiscation years, LMFs manage aggregate, revenue and expense accruals more than LWFs do, in order to smooth earnings and disguise/carry out money laundering. In contrast, in the post-confiscation years, there is no significant difference in the level of accrual management between LMFs and LWFs, as a consequence of the effective intervention of legal administrators.
Originality/value – This study adopts discretionary revenue and expense accrual proxies that provide additional insight into the simultaneous manipulation of revenues and expenses, linked to money laundering, which may not be fully detected by traditional aggregate accrual models. Furthermore, it suggests that the incentive for LMFs to manage accruals may be fostered by the irrelevance of their financial statements to trades with stakeholders. Finally, this paper may provide regulators with financial accounting signals which could be included in risk assessment models aiming to detect money laundering activities within firms.

Keywords Fraud, Money laundering, Discretionary accruals, Legally registered Mafia firms

1. Introduction

This paper aims to understand whether accounting information can contribute to understanding the mechanisms of criminal funding and money laundering in specific socio-economic and political contexts. On this matter, Compin (2008) asserts that one of the roles of accounting in a criminal business is to mask the crime by ensuring that the accounting information, although deceptive, contains all the necessary virtues and, in turn, maintains an impression of rationality and economic credibility. On the other hand, Neu et al. (2013) suggest that it is the skillful and discretionary use of accounting strategies that simultaneously makes criminal practices (e.g. corruption, money laundering, corporate fraud) possible and organizes criminal networks among politicians, bureaucrats and business actors. Based on these premises, this study specifically investigates how accounting is used to disguise and carry out money laundering activities, and whether specifically developed discretionary expense and revenue accruals models, as well as...
classical models based on aggregate accruals, can provide evidence of such illicit practices carried out through legally registered Mafia firms (LMFs) in Italy. In this regard, LMFs are identified as firms which are legally registered and seemingly carry out legal activities but are controlled, even indirectly through figureheads, by a Mafia organization (Champeyrache, 2004). Previous studies (Gambetta, 1993; Fantò, 1999) outline three particularities of LMFs compared to lawful firms (LWFs), namely, the owners are affiliated with a Mafia organization; financial resources may partially or totally derive from illicit activities; and criminal methods (e.g. intimidation and corruption) are commonly employed while carrying out business. Hence, legal and illegal activities coexist, given that the former are mainly used to launder proceeds deriving from the latter (Fantò, 1999). Furthermore, criminal methods allow LMFs to benefit from competitive advantages over LWFs (Fantò, 1999; Arlacchi, 2007) and a market power arising from the control of artificially scarce resources (Champeyrache, 2014). Indeed, a full understanding of the phenomenon of LMFs cannot disregard their social networks and relationships with local politicians, populations and business actors (Sciarrone, 1998).

A reliable estimate of the presence of LMFs in Italy is hardly achievable. Nonetheless, the relevance of the phenomenon can be inferred from a recent study, performed by Transcrime (2013) on behalf of the Italian Ministry of Interior, which quantifies the annual illegal revenues of Mafias in Italy between 8.3 and 13 billion Euros. Furthermore, 8.7 percent of the total investment of Mafias in the legal economy between 1983 and 2011 is represented by companies and stocks. On the other hand, prior studies document the infiltration of Italian Mafias in the legal economy of several European countries such as Spain and Germany (Forgione, 2009; Roth, 2009; Transcrime, 2013). Importantly, money laundering practices cannot be exclusively related to Italian Mafia organizations. In this regard, Eurostat (2013) statistical study on money laundering in Europe shows that almost all European countries have reported money laundering transactions involving firms in recent years.

The study is based on a sample of 224 Italian firms identified as LMFs, due to having been confiscated at some point by judicial authorities because of their owners being accused of Mafia-type association according to the Article 416-bis of the Italian criminal law. More importantly, according to this article, a charge of Mafia-type association entails the automatic confiscation of all the assets of the accused individual, including firms and related shares, which represent the profit of the crime or its investment. After being confiscated, LMFs are assigned to one or several legal administrators. The legal administration aims to re-establish the legality within the confiscated LMFs while fostering their business performance and level of employment. Hence, this paper examines LMFs both before and after their confiscation by comparing them with a population of unlisted LWFs for which there is no evidence of Mafia infiltration. Indeed, a further objective of the study is to assess whether the confiscation of LMFs has a significant impact on their accrual management practices. In this respect, results showing a null impact of the confiscation might cast doubt on the effectiveness of the legal administration in reinstating the legality within LMFs.

Before formulating the hypotheses, the study analyzes previously documented Mafia money laundering practices and the favorable context for LMFs to adopt them. In particular, the authors refer to social theories, borrowed from other disciplines (O’Dwyer and Unerman, 2014; Parker and Guthrie, 2014), describing the influence of the context on corporate illegal behaviors. Subsequently, the authors envisage how these practices may be reflected in discretionary accruals patterns. Overall, the results reveal that in the pre-confiscation years, LMFs manage aggregate, revenue and expense accruals more than LWFs do, in order to smooth earnings and disguise/carry out money laundering. In the confiscation years, LMFs continue managing accruals more than LWFs do, although for reasons, other than smoothing earnings, which may mostly be linked to adjustments of pre-confiscation misreporting and accounting restatements, involving accrual reversals, carried out by legal administrators.
Specifically, LMFs upward manage both revenue and expense accruals, relative to LWFs, with a negative cumulative effect on aggregate accruals and income. Finally, in the post-confiscation years, there is no significant difference in the level of accrual management between LMFs and LWFs, as evidence of the relevant impact of legal administrators’ takeover on the accounting practices of LMFs. These conclusions confirm previous findings (Stubben, 2010) on the informative superiority of specific accrual models over aggregate accrual models in detecting a combination of revenue and expense manipulation.

This study can be situated within the academic literature on accrual-based earnings management. In this respect, prior research examines accrual management in varying types of firms and contexts which may have some similarities with the case of LMFs in Italy. In particular, different studies analyze accrual management within: firms committing financial statement fraud (Beneish, 1997; Jones et al., 2008; Perols and Lougee, 2011), firms with political connection (Chaney et al., 2011), socially irresponsible firms (Gargouri et al., 2012; Kim et al., 2012), unlisted firms (Ball and Shivakumar, 2005; Coppens and Peek, 2005; Burgstahler et al., 2006) and family firms in Italy (Prencipe et al., 2008). However, these studies mostly focus on aggregate accruals rather than considering each specific type of accruals. Hence, they do not provide information on how the accrual management is achieved and which underlying practices discretionary accruals may reflect. Conversely, this study adopts specifically developed discretionary revenue and expense accrual proxies that, compared to aggregate accrual models, provide additional insight into the simultaneous manipulation of revenues and expenses linked to money laundering activities. Furthermore, although some traits of LMFs may be identified in the firms examined in aforementioned studies on accrual management (e.g. fraudulent purposes, social irresponsibility, political connections, unlisted firms, family ownership, Italian location), this study contributes to the accounting literature, given that, to the best of the authors’ knowledge, it is the first that specifically seeks to relate accrual management to money laundering activities within the context of LMFs. These unlisted firms may be of particular interest to the scientific community due to their singularities. Indeed, they are socially irresponsible by nature and their incentives, operating context and modus operandi differ from those of listed companies. In particular, this study suggests that unlisted firms like LMFs tend to engage more in accrual management for illicit purposes, when specific competitive advantages or a dominant market position make their financial statements irrelevant for trading with stakeholders. Finally, this paper may provide regulators with financial accounting signals which could be included in risk assessment models aiming to detect money laundering activities or similar criminal practices, especially in contexts analogous to that of LMFs.

The remainder of the paper proceeds as follows: Section 2 examines LMFs, their operating context and theories explaining their modus operandi; Section 3 reviews the literature on discretionary accruals proxies and develops the hypotheses; Section 4 describes the sample data and the research design; Section 5 presents empirical results; and Section 6 includes discussion of the results and concluding remarks.

2. LMFs: operating context and theory

One of the main reasons for Mafia organizations to take on new businesses is to be able to launder considerable financial resources stemming from illicit trafficking. In this way, as well as enhancing their profits, Mafia organizations strengthen their power and social acceptance by granting employment opportunities to the population in the territory under their control (Fantò, 1999; Riccardi, 2014; Sciarrone, 2014). Fantò (1999) argues that the main features of LMFs lie in the essence of the capital accumulation process that determines their creation as well as in the use of the intimidation which is typical of their modus operandi. In particular, the Mafia intimidation alongside other criminal methods grants LMFs some
competitive advantages over LWFs. Specifically, Arlacchi (2007) indicates three competitive advantages of LMFs over LWFs, namely, discouragement of competitors (e.g. obtaining goods at reduced prices, as well as public contracts awarded using intimidation and corruption); labor cost compression (e.g. evasion of social security charges, circumvention of labor market regulations); and availability of black money stemming from illicit trafficking without incurring the cost of debt.

The economic, social, political and institutional context is favorable for LMFs to thrive and engage in fraudulent practices. In particular, the influence of the context is implicit in a model, usually defined as fraud triangle, in which illegal corporate behaviors are attributable to the interactive effects of motivation or pressure to engage in corporate illegality, opportunity for it to occur (e.g. ineffective control), and personal attitude (ethical values) allowing the rationalization of the dishonest act (Wilks and Zimbelman, 2004; Cohen et al., 2010; Morales et al., 2014). These fraud triggering factors could be identified in LMFs. Indeed, LMFs may be a means of Mafiosi owner managers to launder dirty money and achieve profits by engaging in illegal practices, under the protection of the criminal organization granting competitive advantages over LWFs. Rationalization processes for the self-justification of illegal behaviors may also occur among employees (Cohen et al., 2010) who may be pressured because of their dependence on LMFs for their livelihood in economically depressed Southern Italian regions, where LMFs are mostly located. In this regard, the power of Mafiosi owners, based on the control of scarce economic resources, can be identified as a context feature that supports illegal practices within LMFs as well as their development (Lukes, 2005; Palmer, 2012).

In particular, Champeyrache (2014) proposes an institutional theory supporting artificial scarcity (Veblen, 1915, 1921) as the functioning principle of LMFs. This means that Mafia organizations use LMFs to voluntarily and collectively create an imbalance between supply and demand (scarcity) in markets they infiltrate, in order to dominate decollectivized non-mafiosi individuals (Dugger, 1989). More specifically, LMFs create artificial scarcity by controlling and restricting to individuals outside their criminal network the access to resources and final goods in the territories under their sovereignty. At the same time, the economic power granted by artificial scarcity fosters the social status and the mystification of Mafia organizations which allow LMFs to gain social legitimacy (Dugger, 1980). Indeed, non-mafiosi interpret these barriers to accessing goods as a restriction due to their lack of inclusion in the upper strata, creating an incentive to emulate LMFs and abide by mafia rules to access goods (Champeyrache, 2014). In particular, LMFs use their competitive advantages (e.g. superior access to liquidity) and other criminal methods to take over strategic sectors (e.g. raw material market and public procurement) and establish monopolistic high prices for scarce resources which prevent would-be and existing entrepreneurs from freely developing activities and individual talents (Arlacchi, 2007). Furthermore, LMFs consolidate their market power by expelling non-mafiosi entrepreneurs from infiltrated markets or taking control of their firms using direct violence and/or asphyxiations through usurious loans (Masciandaro, 1997; Champeyrache, 2004). Specifically, Mafia organizations are able to benefit from situations of economic crisis, by offering financial resources to entrepreneurs who have difficulty in accessing credit, or by taking over troubled businesses as fronts for money laundering (Riccardi, 2014; Sciarrone and Storti, 2014). The tendency of LMFs to establish a monopoly power is consistent with previous studies, finding that the sectors more vulnerable to Mafia infiltration are characterized by a low technological level, high labor and cash intensity, predominance of small-medium enterprises that compete on the local market (e.g. construction), low international competition and strong public regulation (e.g. competitive bidding) which allows the Mafia to put pressure on policy makers and gain advantageous positions in accessing public resources (Lavezzi, 2008; Riccardi, 2014; Sciarrone and Storti, 2014).
On the other hand, other studies focus on the influence of the institutional context upon
corporate illicit practices (Misangyi et al., 2008; Cooper et al., 2013; Gabbioneta et al., 2013).
In this regard, unlike other forms of organized crime for which making a profit is the
primary goal (Finckenauer, 2005), the Mafia is not oriented exclusively toward profit
making, but rather it also seeks power (Sciarrone, 2014). Indeed, Mafia organizations can be
regarded as politico-institutional authorities that seek political control of the territories
where they are established by sharing forms of government and governance with the state
and local authorities (Catanzaro, 1985; Mattina, 2011). In this respect, Dickie (2004, pp. 67-78)
asserts that the central political authorities of Italy have repeatedly relied on the Mafia to
serve as an instrument of local government during periods of turmoil in Sicilian history.
It can be inferred that the development of Mafia-type activities is more likely in weak
governance contexts where political institutions are absent or have failed to enforce rules
regulating economic processes and protecting property rights (Catanzaro, 1985; Gambetta,
1993; Venkatesh, 1997). In addition, ineffective institutions foster corrupt practices and the
private appropriation of public resources which may result in a widespread lowering of the
sense of legality (Della Porta and Vannucci, 2011).

The infiltration of Mafia organizations in political institutions is mainly achieved by
distorting electoral outcomes and intervening in the market for votes (Buonanno et al., 2016).
In particular, Mafia organizations procure votes to politicians (through either threats or
rewards to citizens) and/or finance their political campaigns in exchange for favors
represented by diversion of public funds and procurement contracts, favorable legislation and
lenient prosecution (Gambetta, 1993). Importantly, the deep infiltration of Mafia organizations
in public and political institutions and the weak legality culture of their members may
undermine the “arm’s length” social distance required for independent scrutiny and appraisal
(Westphal and Clement, 2008; Gabbioneta et al., 2013). In this regard, prior research finds that
government auditors work at the discretion of important political actors (Neu et al., 2013) and,
in certain situations, they avoid investigating, discovering and reporting on potentially
problematic acts, such as influence peddling and corruption, which may have political
consequences (Radcliffe, 2008; Neu et al., 2015). This situation may offer a fertile institutional
context, not only for illicit behaviors with a relatively low risk of detection, but also for LMFs
to thrive and expand (Gond et al., 2009). In this respect, various sociological studies and
investigations by judicial authorities show the capacity of LMFs to take part in the processes
by which contracts for public works are awarded, through both their capacity for intimidation
and the control they exert over local authorities (Capacchione, 2008; Di Fiore, 2008). Above and
beyond capitalist accumulation, this capacity to dominate markets and carry out works gives
Mafia organizations a high degree of political and institutional legitimacy, shared with the
authorities, due to the greater importance now, given to private enterprise in establishing and
delivering public policy in mechanisms of territorial governance (Mattina, 2011).

Finally, institutional theories state that the regulatory scrutiny is dampened to the extent
that an organization achieve an institutional ascription of probity by openly conforming to
social expectations, although only symbolically (Bromley and Powell, 2012; Gabbioneta
et al., 2013). In particular, LMFs meet social expectations and gain social consensus and
support by redistributing revenues and providing employment in depressed Southern
Italian regions (Gambetta and Reuter, 1995; Calderoni and Riccardi, 2011). Hence, this
support from at least some of the local population may protect LMFs and discourage local
authorities’ inspections and interventions even in case of suspicions of illicit practices.
In this respect, Sciarrone (1998) asserts that Mafia organizations have a social capital of
relations within civil society, the political world and local populations due to their ability to
form social networks and relationships, to set up exchanges, create ties of trust, exchange
and favors and establish reciprocal duties. These socio-territorial roots and the construction
of a capital of social relations are a primary underlying reason for the persistence of Mafias.
That said, this study aims to determine whether the singularity of the LMFs objectives, *modus operandi* and operating context is somehow reflected in their accounting practices. Specifically, the authors focus on accrual management strategies which may allow LMFs both to mask and to realize criminal activities, by facilitating the organization of criminal networks and transactions among politicians, bureaucrats and businessmen (Compin, 2008; Neu et al., 2013). Importantly, the findings of this study may be generalizable to any criminal organization which infiltrates the legal economy in order to launder money and enhance its profits. Indeed, previous studies highlight the centrality of accounting within organized criminal networks and the similarities among the accounting practices adopted by different criminal organizations in pursuing their illicit purposes (Neu et al., 2015; Sargiacomo et al., 2015).

3. Discretionary accruals proxies and hypotheses on accrual management within LMFs

Prior studies use a wide variety of discretionary accruals measures as surrogates for accrual management (Kothari et al., 2005; Cohen and Zarowin, 2010; Badertscher, 2011; Zang, 2012). However, these studies mostly focus on aggregate accruals rather than considering each specific type of accruals. In this regard, previous research questions aggregate accruals models for providing biased and noisy estimates of discretion (Dechow et al., 1995; Stubben, 2010). Furthermore, McNichols and Wilson (2000) suggest that future progress in the accrual management literature is more likely to come from the examination of specific accruals. In confirmation of this, in a following study, Stubben (2010) finds that revenue accrual models are more likely than aggregate accrual models to detect a combination of revenue and expense manipulation within a sample of firms subject to SEC enforcement actions. On the other hand, Zhong et al. (2010) show that US software firms’ method shift from revenue accrual management to expense accrual management in response to the issuance in 1997 of a new reporting standard (SOP 97-2) that places restrictions on the recognition of software revenue. Hence, following previous research (Caylor, 2010; Stubben, 2010; Zhong et al., 2010; Capalbo et al., 2014), this study measures accrual management by estimating discretionary revenue accruals (*DREVAC*), discretionary expense accruals (*DEXPAC*) as well as discretionary aggregate accruals (*DACC*). In essence, the authors consider that LMFs may resort to a combination of revenue and expense manipulation, for example, through fictitious transactions, in order to achieve their illicit purposes. As manipulation of revenues and expenses can be performed in the same direction, its presence may not be revealed by discretionary aggregate accrual models which do not provide evidence of the earnings elements actually managed and of the way accrual management is specifically carried out (Marquardt and Wiedman, 2004; Stubben, 2010). Moreover, unlike other specific accruals (e.g. allowance for bad debts, depreciations, etc.), revenue and expense accruals are common across industries and represent a large portion of the earnings discretion available to firms (Stubben, 2010). Finally, similar to previous studies (e.g. Kim et al., 2012; Capalbo et al., 2014), this paper initially employs the unsigned value of the aforementioned accrual management proxies. Indeed, accrual management can be either income increasing or income decreasing, and the authors do not have reasons for expecting any of them to be prevalent within LMFs in the long term.

Prior to carrying out this research, the authors expect higher accrual management intensity within LMFs before confiscation relative to LWFs. These expectations are based both on the characteristics of LMFs and on some previous studies examining firms with similarities in certain aspects. In particular, prior studies assume that accrual management is mostly performed to boost earnings rather than reducing them, mainly because they analyze listed companies (e.g. Cohen and Zarowin, 2010; Badertscher, 2011; Kim et al., 2012; Zang, 2012).
In contrast, this study examines unlisted firms whose incentives and accrual management patterns may differ from those of listed companies. In this regard, previous studies identify tax avoidance as a primary incentive for accrual management in unlisted firms, especially in countries with strong alignment of financial and tax accounting (Ball and Shivakumar, 2005; Burgstahler et al., 2006; Van Tendeloo and Vanstraelen, 2008; Marques et al., 2011). In particular, in these countries, including Italy (Hung, 2000; Coppens and Peek, 2005), firms prefer a low volatility in earnings (Ball et al., 2000; Coppens and Peek, 2005). Indeed, third-party effect, in the form of tax demanded by tax authorities, makes communication with stakeholders costly and can be interpreted as a breakdown of the revelation principle assumption justifying the benefit of income-decreasing accrual management (Arya et al., 1998; Walker, 2013).

It is worth mentioning that all Italian companies are required to draw up annual statutory financial statements which should be approved by the shareholders’ meeting within 120 days after the closing year end. Within 30 days from the aforementioned approval, financial statements must be filed with the Register of Companies, kept by the Chambers of Commerce, where they are publicly available. The rules disciplining the mentioned financial statements are set forth in the Italian Civil Code (articles from 2423 to 2429), compliant with 2013/34/UE Directive, and in the set of Italian GAAPs issued by the Organismo Italiano di Contabilità (Italian Accounting Standard Setter)[1]. In this respect, the Italian legislative decree no. 38/2005 requires the adoption of IFRS only for the listed companies, without the option for the unlisted firms to similarly adhere to IFRS. Hence, the financial statements of the unlisted firms of this study are prepared according to the same legally defined Italian GAAP. Importantly, Italian GAAPs are significantly affected by tax considerations, given that, for example, taxable deductible expenses should necessarily be recorded in the income statement and the accounting income is the basis for the calculation of the taxable income[2] (Nobes, 2008; Venuti, 2010; Gavana et al., 2013). It is noteworthy that Italian unlisted companies are generally obliged to get their financial statements audited. However, in most cases, the audit can be carried out by a board of statutory auditors (so-called Collegio Sindacale) as an alternative to an external audit firm. This is always applicable for companies legally established as limited liability companies (Società a Responsabilità Limitata (S.r.l.)). Furthermore, based on Article 2477 of Civil Code, the audit is not mandatory for S.r.l. that are not required to prepare consolidated financial statements; do not control another company obliged to have an audit; and do not exceed for two years two of three size limits[3]. These lower audit requirements may be a primary reason for LMFs being almost exclusively established as S.r.l.

On the other hand, the use of financial statements in contracting with stakeholders (e.g. banks, customers, suppliers, employees) reduces incentives for unlisted firms to engage in accrual management for tax avoidance purposes (Klassen, 1997; Beatty and Harris, 1999; Coppens and Peek, 2005). Indeed, an income-decreasing accrual management may negatively affect the terms of trades with the aforementioned stakeholders as well as resulting in other negative consequences, including larger costs of debt and equity or a higher likelihood of a lawsuit (Francis et al., 2005; Ibrahim et al., 2011). In this regard, based on a survey of US financial executives, Dichev et al. (2013) find that the earnings management motivations to avoid any violation of debt covenants and influence non-capital stakeholders are much stronger for unlisted firms, relative to listed firms, consistent with the lower dependence on capital markets and the higher emphasis on contractual considerations. Nonetheless, LMFs can usually count on financial resources coming from illegal activities which reduce the need for bank financing and the related incentive to report a positive financial performance or an acceptable accrual quality. This latter incentive is further weakened because of the usage of criminal methods, such as intimidation and bribery, to obtain favorable terms in trades with other stakeholders including suppliers,
customers and employees. Hence, LMFs do not have to face trade-offs in their financial and tax reporting decisions.

Assuming tax avoidance as a main incentive for LMFs to engage in accrual management, the authors expect LMFs to prefer small profits to large profits as well as a low volatility in earnings. Indeed, a low volatility allows to consistently report stable small profits by avoiding both high earnings, leading to high tax payments, and negative earnings which may increase the probability of being investigated by tax authorities (Herrmann and Inoue, 1996; Coppens and Peek, 2005). Hence, LMFs may use discretionary accruals to sustainably smooth earnings over a long period. These considerations lead to the first hypothesis of this study:

**H1a.** In the pre-confiscation years, LMFs smooth earnings through discretionary accruals more than LWFs do.

Money laundering, a raison d’être for LMFs, is a structured activity aiming to conceal the illegal source of criminal proceeds by disguising them as lawful earning. Three basic money laundering stages can generally be identified: placement, layering and integration (Buchanan, 2004; He, 2010). Placement is the process of introducing the proceeds from illegal activities into the financial system in a way that government authorities are not able to detect. Layering is the process of generating complex financial transactions to distance the funds from their point of criminal origin and ownership. Finally, integration is the conversion of the illegal proceeds into apparently legitimate business earnings through normal financial or commercial operations.

The money laundering stages in which LMFs are engaged may depend on their activities and characteristics. Specifically, the set-up or acquisition of a firm by Mafia members can be carried out with proceeds of illicit activities and be part of the money laundering integration stage. However, LMFs can also be involved in the other two stages. In particular, Martocchia *et al.* (2014) examine several cases of LMFs engaging in the so-called trade-based money laundering which is among the most used layering techniques (Maitland Irwin *et al.*, 2012). The Financial Action Task Force (2006) defines trade-based money laundering as: the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origins. More specifically, first, LMFs get public contracts awarded using bribery, intimidation and other forms of influence over the public administration and especially over local public officials and politicians (Caneppele *et al.*, 2009; Savona, 2010). Subsequently, LMFs use false or inflated invoicing for work not performed or material not used or not meeting specifications, in order to create business expense records and to transfer cash to colluded parties that subsequently kick the money back to Mafia organizations and/or corrupt public officials. Trade-based money laundering is strictly linked to tax avoidance practices, given that the misrepresentation of value of trade transactions has a direct effect on value-added tax and income tax.

Money laundering through cash intensive businesses (Gilmour and Ridley, 2015) is a further method used to deposit illicit cash into the banking sector (placement). In this method, a business typically expected to receive a large proportion of its revenue as cash uses its accounts to deposit criminally derived cash, as well as legitimate cash, by falsifying receipts and invoices (Fántó, 1999; Fiorentini, 1999). LMFs of cash-intensive sectors (e.g. retail stores, convenience stores, hotels, restaurants, etc.) may be involved in the placement stage of money laundering. This practice may be particularly typical for long-living LMFs permanently established in the territory which have managed to gain a social consensus and a consolidated banking profile (Levi and Reuter, 2006; Gilmour and Ridley, 2015). Another money laundering placement technique, commonly adopted by LMFs, is based on the payment of “black salaries” to employees using dirty money (Caneppele *et al.*, 2009; Martocchia *et al.*, 2014).
The aforementioned money laundering practices within LMFs may be carried out through transaction management affecting cash flow from operations (CFO) during the fiscal year and resulting in abnormal expense and revenue patterns shown in their financial statements. In this regard, in the survey conducted by Graham et al. (2005), financial executives of US-listed companies express a preference for managing earnings through real transactions affecting CFO rather than through accruals. However, a wider usage of accruals can be assumed in LMFs relative to listed firms. In particular, accrual management may be a necessary complement of transaction management carried out through false trade documents in order to disguise money laundering (Caneppele et al., 2009; Martocchia et al., 2014; Gilmour and Ridley, 2015). Indeed, discretionary accruals may allow adjusting abnormal and fraudulently manipulated expenses/revenues at year end, while keeping an impression of rationality and economic credibility of the accounting information (Compin, 2008). Hence, a more intensive accrual management within LMFs may be the natural consequence of opportunistically manipulated accounting information that does not reflect the patterns of a standard business activity. For example, abnormally large changes in revenues, due to fraudulent manipulations within LMFs, are likely to result in higher discretionary accruals, given that change in revenues is a predictor variable of the accrual models.

Moreover, the authors expect a higher level of accrual management for LMFs due to their less intensive scrutiny from outsiders relative to LWFs, arising from the protection granted by the social networks established by Mafia organizations which are deeply infiltrated in the Italian institutions (Sciarrone, 1998). In this regard, prior research suggests that a low external monitoring intensity determines a more intensive accrual management (Duellman et al., 2013; Wongsunwai, 2013). In particular, some similarities may be identified with the politically connected firms examined by Chaney et al. (2011) which exhibit higher accrual management than firms lacking such connections. Indeed, political institutions infiltrated by the Mafia (Gambetta, 1993; Buonanno et al., 2016) may provide protection to LMFs so that low-quality accounting information is not penalized and constraints in the strategic use of accrual management are further reduced. In addition, the lack of managerial competencies may also negatively affect the quality of the accounting information. Indeed, in LMFs, the allegiance to the Mafia family may be considered as the essential criterion for appointing future agents often recruited from a relatively small pool of affiliates and trustees (Duplat et al., 2012). Conversely, in LWFs, the selection process is largely driven by the skills and abilities of these candidates to run the business. Based on previous considerations, this study empirically tests the following research hypothesis:

\[ H2a. \] In the pre-confiscation years, LMFs manage aggregate, revenue and expense accruals more than LWFs do.

After confiscation, most of LMFs fall into financial distress and often end up in liquidation (ANBSC, 2012). The main reasons for that may be the loss of privileged and illegal business opportunities; the increase in operating expenses (e.g., regularization of undeclared workers and increase in service expenses for external support); and the shortage of funding, given that the dirty money flow is interrupted and banks are more reluctant to grant credit. In this respect, previous studies find that distressed firms prior to bankruptcy engage in income-increasing accrual management in order to conceal the deteriorating financial conditions until they improve (Rosner, 2003; Charitou et al., 2007; García Lara et al., 2009). More importantly, after the confiscation, one of the tasks of legal administrators is the reinstatement of the legality within LMFs. Hence, accounting adjustments, including accrual reversals, to correct previous misreporting and the settlement of some transactions may still lead to higher accrual management measures relative to LWFs in the year of confiscation, although for different reasons from those prior to confiscation. In particular, earnings
smoothing and money laundering concealing may no longer be the main incentives. Therefore, the further hypotheses of this study are:

$H1b$. In the confiscation year, there is no significant difference between LMFs and LWFs in the level of earnings smoothing through discretionary accruals.

$H2b$. In the confiscation year, LMFs manage aggregate, revenue and expense accruals more than LWFs do.

On the other hand, in the years following the confiscation year and the consequent re-establishment of the legality in the accounting transactions carried out by legal administrators, the authors expect practices of LMFs to be more aligned to those of LWFs with no significant difference in their degree of accrual management. Indeed, the control of legal administrators may substantially weaken the influence of the Mafia over LMFs and lead to the suspension of any money laundering activity as well as of any criminal method while doing business. Hence, the final hypotheses of the study are:

$H1c$. In the post-confiscation years, there is no significant difference between LMFs and LWFs in the level of earnings smoothing through discretionary accruals.

$H2c$. In the post-confiscation years, there is no significant difference between LMFs and LWFs in the level of aggregate, revenue and expense accrual management.

4. Methodology

4.1 Data and sample selection

The sample of LMFs is composed of 224 firms confiscated to Mafia organizations. Some firms are provided by National Agency for the Management and Assignment of Seized and Confiscated Assets (ANBSC) which is the national body currently in charge of the management and assignment of assets, including firms seized and confiscated to Mafia organizations by Italian judicial authorities. Additional firms are obtained from online newspapers and AIDA database[4]. The financial statements are extracted from AIDA, the Italian Bureau Van Dijk database. It includes financial information on 1 million Italian companies with sales above €500,000, indicating, for some of them, the status of confiscated and the related date. Only 54 firms received from ANBSC are included in AIDA, mostly because of their small size. Additionally, the authors include LMFs confiscated found on AIDA database (118) and online newspapers (52)[5]. For the 224 LMFs, the authors obtain available financial statement data from AIDA for the year of confiscation and for the pre-confiscation and post-confiscation years within the period from 2003 to 2012. The authors then estimate the base regression model of Equation (7) including LMF years and AIDA population of active unlisted firm ears from 2003 to 2012 in LMF industries. This study initially avoids the matched sample procedure because of the concerns on its validity raised by Cram et al. (2009). However, the base regression model includes control variables for year, size and two-digit industry SIC code. Table I presents the sample selection process which leads to the 224 LMFs and the 78,340 LWFs.

Table II shows the industry distribution of LMFs and active unlisted firms included in AIDA from 2003 to 2012 in the same two-digit SIC codes as those of LMFs. Pearson $\chi^2$ test of independence shows that the industry distribution of LMFs is significantly different from that of AIDA firm population ($\chi^2(34) = 230; p < 0.01$). Specifically, LMFs are comparatively more abundant in SIC code 15 (18.30 percent of LMFs sample vs 7.00 percent of population), SIC code 42 (8.04 percent vs 3.69 percent) and SIC code 54 (7.14 percent vs 2.22 percent). In contrast, LMFs are proportionally less numerous in SIC code 50 (10.27 percent vs 17.95 percent), SIC code 34 (0.89 percent vs 8.98 percent) and SIC code 73 (0.89 percent vs 6.38 percent).
It is noteworthy that construction (SIC codes 15-17) is the sector with the highest cumulative percentage (23.21 percent) of LMFs in the sample. Indeed, construction is a sector with a high concentration of public contracts whose control represents a relevant business for Mafia organizations (Caneppele et al., 2009; Savona, 2010). Wholesale trade (SIC codes 50-51) is the second most representative sector (18.75 percent) in LMFs sample, followed by transportation & public utilities (SIC codes 42-49 – 13.41 percent) and retail trade (SIC codes 52-59 – 12.96 percent). These latter sectors are cash-intensive and/or supply cash-intensive businesses which are particularly suitable for depositing illicit cash into the banking sector (Gilmour and Ridley, 2015). Furthermore, the wholesale and retail trade sectors include a wide range of subsectors that can be exploited for illegal activities of different kinds, such as counterfeiting (e.g. in the case of the wholesale and retail trade of clothing and textiles) or drugs trafficking (e.g. in the case of import/export companies) (Lo Bello, 2011; Savona and Riccardi, 2015). Cumulatively, the industry distribution of LMFs in the sample is consistent with previous studies that find LMFs mostly concentrated in sectors characterized by scant openness to foreign investments, low-tech industries, cash and labor- intensiveness, small-medium enterprises, strong deregulation, high territorial distinctiveness and high involvement of public resources and public authorities (Savona, 2015).

4.2 Accrual management proxies (dependent variables)

In order to test the hypotheses, this study adopts several measures of discretionary accruals. In particular, the authors compute discretionary aggregate accruals (DACC) as the residuals from the modified Jones model adjusted for performance (Kothari et al., 2005) presented in the Equation (1). Its coefficients are estimated cross-sectionally for each industry year:

\[
\frac{ACCR_t}{TA_{t-1}} = \beta_0 + \beta_1 \frac{1}{TA_{t-1}} + \beta_2 \frac{\Delta REV_t - \Delta AR_t}{TA_{t-1}} + \beta_3 \frac{PPE_t}{TA_{t-1}} + \beta_4 ROA_{t-1} + \epsilon_t
\]

where in year t (or t-1): \(ACCR\) is total accruals; \(TA\) is total assets; \(\Delta REV\) is changes in net revenue; \(\Delta AR\) is change in accounts receivables; \(PPE\) is property, plant and equipment; and \(ROA\) is return on assets. Consistent with previous studies on accrual management (e.g. Dechow et al., 1995; Bergstresser and Philippon, 2006), \(ACCR\) are computed as:

\[
ACCR_t = \Delta CUA_t - \Delta CUL_t - \Delta CASH_t + \Delta STD_t - DEPR_t
\]
where $\Delta CUA$ is change in current assets relative to previous year; $\Delta CUL$ is change in current liabilities relative to previous year; $\Delta CASH$ is change in cash and cash equivalents relative to previous year; $\Delta STD$ is change in short term debt relative to previous year; and $DEPR$ is depreciation and amortization.

In the estimations of Equation (1), the authors employ all active unlisted firms included in AIDA (LMFs excluded) with financial statements available from 2003 to 2012. The total number of these firms at the moment of its retrieval from AIDA is 78,340.

Furthermore, similar to Stubben (2010) and Caylor (2010), the authors calculate discretionary revenue accruals ($DREVAC$) as the residuals from the following Equation (3) estimated in the same way as Equation (1). In line with Caylor (2010), this paper assumes that changes in accounts receivables are positively related to future changes in cash flow.

<table>
<thead>
<tr>
<th>SIC code</th>
<th>Industry description</th>
<th>AIDA population</th>
<th>LMFs</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Agricultural production-crops</td>
<td>644</td>
<td>4</td>
</tr>
<tr>
<td>14</td>
<td>Mining and quarrying of non-metallic minerals, except fuels</td>
<td>463</td>
<td>9</td>
</tr>
<tr>
<td>15</td>
<td>Building construction — general contractors and operative builders</td>
<td>5,486</td>
<td>41</td>
</tr>
<tr>
<td>16</td>
<td>Heavy construction other than building construction — contractors</td>
<td>524</td>
<td>3</td>
</tr>
<tr>
<td>17</td>
<td>Construction — special trade contractors</td>
<td>4,032</td>
<td>8</td>
</tr>
<tr>
<td>20</td>
<td>Food and kindred products</td>
<td>3,224</td>
<td>6</td>
</tr>
<tr>
<td>25</td>
<td>Furniture and fixtures manufacturing</td>
<td>829</td>
<td>3</td>
</tr>
<tr>
<td>28</td>
<td>Chemicals and allied products manufacturing</td>
<td>1,598</td>
<td>1</td>
</tr>
<tr>
<td>29</td>
<td>Petroleum refining and related industries</td>
<td>158</td>
<td>2</td>
</tr>
<tr>
<td>32</td>
<td>Stone, clay, glass and concrete products manufacturing</td>
<td>1,960</td>
<td>13</td>
</tr>
<tr>
<td>34</td>
<td>Fabricated metal products, except machinery and transportation</td>
<td>7,038</td>
<td>2</td>
</tr>
<tr>
<td>42</td>
<td>Motor freight transportation and warehousing</td>
<td>2,894</td>
<td>18</td>
</tr>
<tr>
<td>44</td>
<td>Water transportation</td>
<td>586</td>
<td>1</td>
</tr>
<tr>
<td>45</td>
<td>Transportation by air</td>
<td>95</td>
<td>1</td>
</tr>
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<td>47</td>
<td>Transportation services</td>
<td>1,884</td>
<td>3</td>
</tr>
<tr>
<td>49</td>
<td>Electric, gas and sanitary services</td>
<td>1,419</td>
<td>7</td>
</tr>
<tr>
<td>50</td>
<td>Wholesale trade, durable goods</td>
<td>14,064</td>
<td>23</td>
</tr>
<tr>
<td>51</td>
<td>Wholesale trade, non-durable goods wholesale dealing in</td>
<td>7,821</td>
<td>19</td>
</tr>
<tr>
<td>52</td>
<td>Building materials, hardware, garden supply and mobile home dealers wholesale dealing in</td>
<td>1,018</td>
<td>1</td>
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<tr>
<td>53</td>
<td>General merchandise stores</td>
<td>324</td>
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<tr>
<td>54</td>
<td>Food stores</td>
<td>1,737</td>
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<tr>
<td>55</td>
<td>Automotive dealers and gasoline service stations</td>
<td>536</td>
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</tr>
<tr>
<td>56</td>
<td>Apparel and accessory stores</td>
<td>1,920</td>
<td>3</td>
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<tr>
<td>57</td>
<td>Home furniture, furnishings and equipment stores</td>
<td>872</td>
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</tr>
<tr>
<td>58</td>
<td>Eating and drinking places</td>
<td>1,007</td>
<td>2</td>
</tr>
<tr>
<td>59</td>
<td>Miscellaneous retail</td>
<td>3,475</td>
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<td>65</td>
<td>Real estate</td>
<td>2,239</td>
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<tr>
<td>70</td>
<td>Hotels, rooming houses, camps and other lodging places</td>
<td>1,600</td>
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<tr>
<td>72</td>
<td>Personal services</td>
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<tr>
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<td>Business services</td>
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<tr>
<td>75</td>
<td>Automotive repair, services and parking</td>
<td>882</td>
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<tr>
<td>79</td>
<td>Amusement and recreation services</td>
<td>744</td>
<td>5</td>
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<td>80</td>
<td>Health services</td>
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<tr>
<td>81</td>
<td>Legal services</td>
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<td>1</td>
</tr>
<tr>
<td>87</td>
<td>Engineering, accounting, research, management and related services</td>
<td>2,755</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>78,340</strong></td>
<td><strong>224</strong></td>
</tr>
</tbody>
</table>

**Source:** AIDA database, 2013

Table II. Industry distribution of LMFs and active unlisted firms available on AIDA from 2003 to 2012 in the same LMFs two-digit SIC codes

297
from operations (CFO) as well as contemporaneous changes in revenues, since the receivable amounts will be collected in the next period:

\[
\frac{\Delta AR_t}{TA_{t-1}} = \beta_0 + \beta_1 \frac{1}{TA_{t-1}} + \beta_2 \frac{\Delta REV_t}{TA_{t-1}} + \beta_3 \frac{\Delta CFO_{t+1}}{TA_{t-1}} + \epsilon_t
\]  

(3)

As the statement of CFO is not legally required for unlisted firms in Italy, CFO is computed as: earnings before tax−ACCR.

Following the same rationale as \textit{DREVAC}, the authors additionally compute discretionary expense accruals (\textit{DEXPAC}) as the residuals from the Equation (4) model which is estimated like Equation (1):

\[
\frac{\Delta AP_t - \Delta INV_t}{TA_{t-1}} = \beta_0 + \beta_1 \frac{1}{TA_{t-1}} + \beta_2 \frac{\Delta REV_t}{TA_{t-1}} + \beta_3 \frac{\Delta CFO_{t+1}}{TA_{t-1}} + \epsilon_t
\]  

(4)

where \(\Delta AP\) and \(\Delta INV\) represent change in accounts payables and change in inventory, respectively. Positive \textit{DEXPAC} result in an income-decreasing effect due to a discretionary increase of payable invoices (\(\Delta AP\)) at year end which is not offset by a corresponding discretionary increase in inventory (\(\Delta INV\)). The situation is exactly the opposite in case of negative \textit{DEXPAC}.

It is noteworthy that the definition of total expense accruals, included as dependent variable in Equation (4), is in line with that adopted in the aforementioned study of Zhong \textit{et al.} (2010). However, Zhong \textit{et al.} (2010) remove the non-discretionary component of expense accruals by adding specific control variables in the final regression model estimated to test differences in accrual management between software firms and non-software control firms. In contrast, this study first isolates the discretionary component of expense accruals (\textit{DEXPAC}) by computing the residuals of the Equation (4) model. Subsequently, \textit{DEXPAC} is used as the dependent variable of the base regression model estimated to test the hypotheses of this paper. This latter approach to measure \textit{DEXPAC} is more similar to that applied by Ibrahim (2009), who estimates discretionary accruals related to expenses as residuals of specific regression models whose predictors are partially different from those of Equation (4).

Finally, following Ghosh and Olsen (2009), the authors measure earnings smoothing (\textit{SMTH}) through discretionary accruals as the volatility, variance (\textit{Var}), of pre-managed earnings relative to the volatility of reported (managed) earnings both deflated by lagged total assets (\textit{LTA}):

\[
\textit{SMTH} = \textit{Var}(\text{Pre - managed earnings}) - \textit{Var}(\text{Reported earnings/LTA})
\]  

(5)

where pre-managed earnings are computed as: Reported earnings/LTA−DACC.

The authors calculate the variances using rolling time intervals of three years in order to minimize the loss of observations. In addition, the authors standardize \textit{SMTH} within each industry year (two-digit SIC). If discretionary accruals are used to reduce the volatility of reported earnings, then this volatility should be less than the volatility of pre-managed earnings. Hence, larger values of \textit{SMTH} indicate more intensive earnings smoothing. Among the different measures of earnings smoothing used in previous studies (e.g. Prencipe \textit{et al.}, 2011; Jung \textit{et al.}, 2013; Bouwman, 2014), the authors believe that the measure adopted by Ghosh and Olsen (2009) best reflects the smoothing effect of discretionary accruals, which are specifically examined in this paper. Indeed, the difference between variability of reported earnings and variability of pre-managed earnings is assumed to be mostly due to the strategic usage of discretionary accruals.
4.3 Control variables and base regression model

As independent variables strictly related to the hypotheses, the authors use binary variables:

- $LMF_{PRECONF}$ taking value of 1 for pre-confiscation LMF years;
- $LMF_{CONF}$ taking value of 1 for LMF years in the confiscation year;
- $LMF_{POSTCONF1}$ taking value of 1 for LMF years in the first year after confiscation year;
- $LMF_{POSTCONF2}$ taking value of 1 for all the following post-confiscation LMF years; and
- $LWF$ taking value of 1 for LWF years.

The latter is excluded from the final regression model as a base variable. Furthermore, this study considers other control variables shown in the prior literature to be associated with accrual management (e.g. Roychowdhury, 2006; Cohen and Zarowin, 2010; Gunny, 2010; Badertscher, 2011; Kim et al., 2012; Zang, 2012; Duellman et al., 2013). Specifically, the authors include absolute change in net income ($ABS\Delta NI$), size ($SIZE$), long-term indebtedness ($LEVLONG$), sum of inventory and receivables ($INVREC$), assets growth ($GROWTH$), financial performance ($ROA$) and an indicator variable for firms reporting losses ($LOSS$). Furthermore, the authors include the current effective tax rate ($ETR$) consistent with the stronger tax avoidance incentive in unlisted firms. The authors also consider the case of firms just meeting zero earnings benchmark that previous studies find to be more likely to engage in income-increasing accrual management (Roychowdhury, 2006; Gunny, 2010; Zang, 2012). In particular, Coppens and Peek (2005) and Burgstahler et al. (2006) find that unlisted firms of several European countries, including Italy, avoid reporting small losses. Therefore, the authors indicate as suspect ($SUSPECT$) firm years with earnings before tax over lagged assets greater than or equal to zero but less than 0.01 (Gunny, 2010). Previous research documents that firms use a mix of earnings management techniques and trade-off between them based on their relative costs (Cohen and Zarowin, 2010; Badertscher, 2011; Zang, 2012). Hence, the authors include a proxy for real earnings management represented by abnormal material costs ($ABMAT$). Based on prior studies (e.g. Roychowdhury, 2006; Kim et al., 2012), it is calculated as the residuals from the following equation whose parameters are estimated similarly to Equation (1):

$$\frac{MAT_t}{TA_{t-1}} = \beta_0 + \beta_1 \frac{1}{TA_{t-1}} + \beta_2 \frac{S_t}{TA_{t-1}} + \beta_3 \frac{\Delta S_t}{TA_{t-1}} + \beta_4 \frac{\Delta S_{t-1}}{TA_{t-1}} + \epsilon_t$$  

where in year $t$ (or $t-1$): $MAT_t$ are material costs including both raw materials and trading goods; and $TA$, $S_t$ and $\Delta S_t$ respectively, represent total assets, net sales and change in net sales relative to previous year. Furthermore, the authors add variable $REVTA$ (revenues divided by total assets), standardized by industry year, whose abnormally high or low values may provide indication of revenue transaction manipulation (Fanning and Cogger, 1998; Perols and Lougee, 2011), which may be associated with accrual management.

Finally, the authors include dummy variables representing industry ($INDSEC$) and year ($YEAR$). In summary, to test the hypotheses, the following base regression model is estimated for the accrual management proxies:

$$AM_{PROXY,t} = \beta_0 + \beta_1 LMF_{PRECONF,t} + \beta_2 LMF_{CONF,t} + \beta_3 LMF_{POSTCONF1,t} + \beta_4 LMF_{POSTCONF2,t} + \beta_5 ABS\Delta NI + \beta_6 SIZE_{t-1} + \beta_7 LLEVLONG_{t-1} + \beta_8 INVREC_{t-1} + \beta_9 GROWTH_{t} + \beta_{10} ROA_{t-1} + \beta_{11} ETR_t + \beta_{12} REVTA_t + \beta_{13} ABMAT_t + \beta_{14} LOSS_t + \beta_{15} SUSPECT_t + \sum \phi_i INDSEC_{it} + \sum z_i YEAR_{it} + \epsilon_t$$  

The variables, whose firm subscript is suppressed for simplicity, are defined in the Appendix.
5. Results

5.1 Descriptive statistics and univariate analysis

Table III shows descriptive statistics for the variables included in the base regression model and related comparisons of pre-, confiscation and post-confiscation LMF years with LWF years. The authors report medians because they are less likely than means to be influenced by extreme observations. All continuous variables are winsorized at the top and bottom 1 percent of their distributions to avoid the influence of outliers.

As regards the dependent variables, the medians of variables \( ABSDACC, ABSDREVAC \) and \( ABSDEXPAC \) are all significantly \( (p < 0.01) \) higher for pre-confiscation LMFs \( (LMF\_PRECONF) \) relative to LWFs, providing a first indication in support of the hypothesis \( H2a \). Conversely, the median of variable \( SMTH \) is higher for \( LMF\_PRECONF \) but not significantly at conventional levels, providing some uncertainty on the support for hypothesis \( H1a \). On the other hand, in the confiscation year \( (LMF\_CONF) \) variables \( ABSDACC, ABSDREVAC \) and \( ABSDEXPAC \) are significantly \( (p < 0.05, p < 0.01, p < 0.01, \) respectively) higher for LMFs, and variable \( SMTH \) is not significantly different, consistent with hypotheses \( H1b \) and \( H2b \). In addition, there is no significant difference in the level of \( SMTH, ABSDACC \) and \( ABSDREVAC \) between LWFs and LMFs in the first post-confiscation year \( (LMF\_POSTCONF1) \), whereas in the following post-confiscation years \( (LMF\_POSTCONF2) \), \( ABSDACC \) and \( SMTH \) are even significantly \( (p < 0.01) \) lower. Finally, variable \( ABSDEXPAC \) is still significantly \( (p < 0.05) \) higher for LMFs in the first post-confiscation year and it only becomes insignificantly different in the following post-confiscation years. Overall, these results provide a first support for \( H1c \) and \( H2c \).

As regards the signed values of the accrual management proxies, there is no significant difference in the level of \( DACC \) between LWFs and pre-confiscation LMFs, indicating a null directional effect on income of accrual management practices within LMFs. In contrast, variable \( DACC \) is negative and significantly \( (p < 0.01) \) lower for LMFs in the confiscation year. On the other hand, variables \( DREVAC \) and \( DEXPAC \) are both positive and significantly higher, at different conventional levels, for LMFs both before confiscation and in the confiscation year. This suggests that LMFs may simultaneously engage in income-increasing revenue accrual management and income-decreasing expense accrual management, whose effects on income are only significant in the year of confiscation, as reflected by the \( DACC \) accrual management proxy. Overall, these results provide a first confirmation of Stubben’s (2010) findings on the superiority of specific accrual models over aggregate accrual models in detecting a combination of revenue and expense manipulation especially in growth firms such as LMFs.

Turning to control variables, it is noteworthy that in the years following the confiscation, LMFs appear significantly \( (p < 0.01) \) more long-term indebted \( (LEV\_LONG) \) than LWFs. This may be due to the loss of the criminal organization support granting financial resources and competitive advantages (Fantò, 1999; Arlacchi, 2007). In addition, both before and after confiscation LMFs are significantly \( (p < 0.01) \) less profitable \( (ROA) \) than LWFs. An overinvestment of financial resources stemming from illegal activities and a downward real earnings management may explain the lower profitability of LMFs before confiscation. On the other hand, the cost of the reinstatement of the legality and the loss of business opportunities and competitive advantages (Fantò, 1999; Arlacchi, 2007) may be the causes after confiscation. A further consistent indication is the significantly \( (p < 0.01) \) higher total assets growth rate \( (GROWTH) \) of LMFs before confiscation, presumably financed with dirty money, that becomes significantly \( (p < 0.01) \) lower after confiscation because of the likely suspension of any money laundering activity. As regards real earnings management variable \( ABMAT \), it is significantly \( (p < 0.01) \) higher for LMFs both before and after confiscation, whereas abnormal revenues \( (REV\_TA) \) are significantly \( (p < 0.01) \) lower both before and after confiscation.
### Panel A: Descriptive Statistics

<table>
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<tr>
<th></th>
<th>LMF_PRECONF</th>
<th>LMF_CONF</th>
<th>LMF_POSTCONF1</th>
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<td></td>
<td>n</td>
<td>Median</td>
<td>n</td>
<td>Median</td>
<td>n</td>
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<td>Dependent variables</td>
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<td></td>
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<td></td>
<td></td>
</tr>
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<td>-0.0386</td>
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<td>0.0950</td>
<td>74</td>
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<td>0.0434</td>
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<td>82</td>
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<td>19.01</td>
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### Panel B: Variable Median Comparison between LMFs and LWFs

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<th>LMF_POSTCONF2</th>
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<td>Test</td>
<td>Difference</td>
<td>Test</td>
<td>Difference</td>
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<td></td>
<td></td>
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<td>-0.0390</td>
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<td>0.0004</td>
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(continued)
Control variables

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<th>p-value</th>
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<th>p-value</th>
<th>Coefficient</th>
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<td>-3.98</td>
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</tbody>
</table>

Notes: Pearson $\chi^2$ test of independence for categorical variables; %LOSS, % of firms with two or more consecutive years of negative income; %SUSPECT, % of firms just beating/meeting the zero earnings before tax benchmark; LMF_PRECONF, pre-confiscation LMF years; LMF_CONF, LMF years in the confiscation year; LMF_POSTCONF1, first post-confiscation LMF years; LMF_POSTCONF2, LMF years following the first post-confiscation LMF years; SMTH, earnings smoothing measure as defined in Equation (5); DACC, aggregate discretionary accruals computed as the residuals from Equation (1); ABSDACC, absolute value of DACC; DREVAC, discretionary revenue accruals computed as the residuals from Equation (3); ABSDREVAC, absolute values of DREVAC; DEXPAC, discretionary expense accruals computed as the residuals from Equation (4); ABSDEXPAC, absolute value of DEXPAC; ABSΔNI, absolute value of change in net income relative to previous year divided by lagged total assets; SIZE, natural logarithm of total assets; LEVLONG, long-term liabilities divided by total assets; INVREC, total inventories and receivables divided by total assets; GROWTH, change in total assets relative to previous year divided by lagged total assets; ROA, income before tax divided by total assets; ETR, current tax expense divided by income before tax; REVTA, total revenues divided by total assets standardized by industry year; ABMAT, abnormal material costs computed as the residuals from Equation (6). The sample full period spans 2003-2012. *, **, *** Significant at 10, 5 and 1 percent levels, respectively, based on a two-tailed Mann-Whitney-Wilcoxon test for the differences in medians of continuous variables.
Table IV shows that Pearson correlations among the control variables of the base regression model in Equation (7) are low (below 0.35), thus providing a first indication that collinearity is unlikely to affect estimations.

5.2 Multivariate regression analysis
In order to test the hypotheses, the authors estimate the model in Equation (7) through a linear regression with standard errors adjusted by a two-dimensional cluster at the firm and year levels (Colin et al., 2011), considering the likely correlation of the residuals across firm and/or over time. Table V presents the results for the unsigned accrual management proxies.

First of all, it is noteworthy that all the estimated regressions are significant at the 0.01 level according to the $\chi^2$ tests. As regards the variables relevant for the hypotheses, the coefficient on $LMF_{PRECONF}$ is positive and significant at conventional levels in all the regressions. These results provide support for $H1a$ and $H2a$, indicating that, relative to LWFs, LMFs before confiscation engage more in earnings smoothing as well as in aggregate, revenue and expense accrual management, respectively. Interestingly, the coefficient on $LMF_{CONF}$ is also positive and significant ($p < 0.01$) in all the regressions except in $SMTH$ regression, where it is not significant at conventional levels, consistent with $H1b$ and $H2b$. Hence, in the confiscation year, LMFs continue engaging more in accrual management than LWFs do, although for reasons other than smoothing earnings. On the other hand, the coefficient on $LMF_{POSTCONF1}$ is not significant at conventional levels in $SMTH$, $ABSDACC$ and $ABSDREVAC$ regressions, whereas it is still positive and significant ($p < 0.01$) in $ABSDEXPAC$ regression. Finally, the coefficient on $LMF_{POSTCONF2}$ is not significant at conventional levels in $SMTH$, $ABSDACC$ and $ABSDREVAC$ regressions, whereas it is only marginally significant ($p < 0.10$) in $ABSDREVAC$ regression. Overall, these latter results provide support for $H1c$ and $H2c$, indicating that, after the accounting adjustments carried out by legal administrators in the year of confiscation, in the post-confiscation years, accrual management in LMFs tends to become consistent with that of LWFs.

As regards the rest of control variables, it is noteworthy that all their coefficients are mostly significant at the 0.01 level and with the expected sign, based on previous studies, with only some few exceptions. In particular, the coefficient on $GROWTH$ is positive and significant ($p < 0.01$) in all the regressions indicating that accrual management is more intensive in faster growing firms. On the other hand, the coefficients on $SIZE$, $LEVLONG$, $ROA$ and $ETR$ are negative and significant at conventional levels, suggesting that larger, more long-term indebted, more profitable and less tax avoider firms engage less in accrual management, respectively. Furthermore, the coefficients on $REVTA$ are positive and significant ($p < 0.01$) in all the regressions providing evidence that firms showing higher abnormal revenues engage more in accrual management. Finally, the coefficient on $ABMAT$ is positive and significant ($p < 0.01$) in $SMTH$, $ABSDACC$ and $ABSDEXPAC$ regressions, whereas it is not significant in $ABSDREVAC$ regression, suggesting that real earnings management through abnormal material costs is mostly reflected in expense accrual management rather than revenue accrual management.

In summary, the multiple regression analysis suggests that before confiscation and in the year of confiscation LMFs manage aggregate, revenue and expense accruals more than LWFs do. In contrast, in the rest of post-confiscation years, after the initial accounting adjustments and restatements performed by legal administrators, LMFs tend to adopt accrual management practices more similar to those of LWFs.

5.3 Additional analyses
5.3.1 Matching procedure. The authors perform a robustness test of the results by estimating the base regression model within a matched sample. Specifically, each LMF year
## Table IV.
Pearson correlations between base regression model variables.

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**Notes:** Variables are defined in the Appendix and in the notes of Table III. *,**,***Significant at 10, 5 and 1 percent levels, respectively, based on a two-tailed test.
is matched to three LWF years on year, industry, sign of ROA and size proxied by total assets. Table VI shows the results of the estimations with standard errors adjusted by a two-dimensional cluster at the firm and year levels.

All the estimated regressions are significant at the 0.01 level according to the $\chi^2$ tests. Results of matched sample estimations are mostly consistent with those of the unmatched sample. Indeed, the coefficients on variables $LMF\_PRECONF$ and $LMF\_CONF$ are positive and significant at conventional levels in all the regressions. However, in $SMTH$ regression, the coefficient on $LMF\_CONF$ is only marginally significant ($p < 0.10$), consistent with the hypothesized weakening of the incentive to smooth earnings. On the other hand, the coefficients on variables $LMF\_POSTCONF1$ and $LMF\_POSTCONF2$ are not significant at conventional levels with the exceptions of the marginally significant ($p < 0.10$) coefficients on $LMF\_POSTCONF1$ in $ABSDEXPAC$ regression and on $LMF\_POSTCONF2$ in $ABSDREVAC$ regression. Overall, these results provide further support for all the hypotheses of this study. As regards the rest of control variables, the signs of the coefficients are mostly consistent with those of the unmatched sample estimations, although some coefficients are not significant at conventional levels.

In summary, the documented robustness of the results to different estimation methods can relieve concerns that the findings are driven by uncontrolled factors.

5.3.2 Regression analysis with signed accrual management proxies. To test the hypotheses, similar to previous studies (e.g. Kim et al., 2012; Capalbo et al., 2014), this study uses the unsigned value of the discretionary accruals proxies given that accrual

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Notes: The $p$-values are two-tailed. Variables are defined in the Appendix and in the notes of Table III.
management can be either income increasing or income decreasing. However, to address the possibility that the difference in accrual management between LMFs and LWFs is also directional in terms of impact on the income, the authors re-estimate the base regression model in Equation (7) using the signed measures of accrual management. Table VII shows the results of the estimations with standard errors adjusted by a two-dimensional cluster at the firm and year levels.

Again, all the estimated regressions are significant at the 0.01 level according to the $\chi^2$ tests. Interestingly, the coefficient on variable LMF_PRECONF is not significant at conventional levels in any regression. These results are plausible, given that in the long-term accrual management can hardly be directional. Indeed, discretionary accruals in one period must reverse in another period (Dechow et al., 2012). Furthermore, earnings smoothing and money laundering concealing may require both positive and negative discretionary accruals.

On the other hand, the coefficient on LMF_CONF is positive and significant ($p < 0.01$) in both DREVAC and DEXPAC regression, whereas it is negative and significant ($p < 0.05$) in DACC regression. Overall, these results suggest that in the confiscation year, LMFs upward manage both revenue and expense accruals, relative to LWFs, with a negative cumulative effect on aggregate accruals and income. Adjustments of pre-confiscation misreporting, including accrual reversals, and the regularization of some transactions carried out by legal administrators may explain these results. Furthermore, there may be uncollectible receivables and outstanding payables, whose settlement is frozen by legal administrators, given that they may be related to fictitious transactions with colluded parties under investigation.

<table>
<thead>
<tr>
<th>Variables of interest</th>
<th>SMTH</th>
<th>ABSDACC</th>
<th>ABDREVAC</th>
<th>ABDEXPAC</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coef.</td>
<td>p-value</td>
<td>Coef.</td>
<td>p-value</td>
</tr>
<tr>
<td>LMF_PRECONF</td>
<td>0.279</td>
<td>0.006</td>
<td>0.024</td>
<td>0.025</td>
</tr>
<tr>
<td>(Expected sign)</td>
<td>(+)</td>
<td>(+)</td>
<td>(+)</td>
<td>(+)</td>
</tr>
<tr>
<td>LMF_CONF</td>
<td>0.407</td>
<td>0.063</td>
<td>0.037</td>
<td>0.025</td>
</tr>
<tr>
<td>(Expected sign)</td>
<td>(+)</td>
<td>(+)</td>
<td>(+)</td>
<td>(+)</td>
</tr>
<tr>
<td>LMF_POSTCONF1</td>
<td>0.099</td>
<td>0.496</td>
<td>0.000</td>
<td>0.998</td>
</tr>
<tr>
<td>LMF_POSTCONF2</td>
<td>0.140</td>
<td>0.240</td>
<td>0.006</td>
<td>0.634</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control variables</th>
<th>Coef.</th>
<th>p-value</th>
<th>Coef.</th>
<th>p-value</th>
<th>Coef.</th>
<th>p-value</th>
<th>Coef.</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABSNI</td>
<td>0.668</td>
<td>0.197</td>
<td>0.300</td>
<td>0.000</td>
<td>0.203</td>
<td>0.001</td>
<td>0.226</td>
<td>0.000</td>
</tr>
<tr>
<td>SIZE</td>
<td>-0.155</td>
<td>0.000</td>
<td>-0.019</td>
<td>0.000</td>
<td>-0.014</td>
<td>0.000</td>
<td>-0.016</td>
<td>0.000</td>
</tr>
<tr>
<td>LEVLONG</td>
<td>0.062</td>
<td>0.702</td>
<td>-0.008</td>
<td>0.607</td>
<td>-0.058</td>
<td>0.000</td>
<td>-0.018</td>
<td>0.166</td>
</tr>
<tr>
<td>INVREC</td>
<td>0.006</td>
<td>0.943</td>
<td>-0.015</td>
<td>0.308</td>
<td>0.027</td>
<td>0.088</td>
<td>0.038</td>
<td>0.000</td>
</tr>
<tr>
<td>GROWTH</td>
<td>0.436</td>
<td>0.000</td>
<td>0.143</td>
<td>0.000</td>
<td>0.108</td>
<td>0.000</td>
<td>0.095</td>
<td>0.000</td>
</tr>
<tr>
<td>ROA</td>
<td>0.027</td>
<td>0.059</td>
<td>0.013</td>
<td>0.736</td>
<td>-0.032</td>
<td>0.271</td>
<td>-0.055</td>
<td>0.130</td>
</tr>
<tr>
<td>ETR</td>
<td>0.011</td>
<td>0.409</td>
<td>-0.003</td>
<td>0.187</td>
<td>-0.003</td>
<td>0.152</td>
<td>-0.001</td>
<td>0.324</td>
</tr>
<tr>
<td>REVITA</td>
<td>0.072</td>
<td>0.036</td>
<td>0.005</td>
<td>0.267</td>
<td>0.017</td>
<td>0.000</td>
<td>0.008</td>
<td>0.010</td>
</tr>
<tr>
<td>ABMAT</td>
<td>0.090</td>
<td>0.327</td>
<td>0.012</td>
<td>0.147</td>
<td>0.013</td>
<td>0.090</td>
<td>0.009</td>
<td>0.239</td>
</tr>
<tr>
<td>LOSS</td>
<td>-0.032</td>
<td>0.739</td>
<td>-0.007</td>
<td>0.369</td>
<td>-0.009</td>
<td>0.042</td>
<td>-0.005</td>
<td>0.507</td>
</tr>
<tr>
<td>SUSPECT</td>
<td>0.026</td>
<td>0.775</td>
<td>0.006</td>
<td>0.538</td>
<td>0.009</td>
<td>0.344</td>
<td>0.018</td>
<td>0.043</td>
</tr>
<tr>
<td>INDSEC dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>YEAR dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Number of obs.        | 3,482 | 3,739   | 3,615 | 3,598   |
| $R^2$                 | 0.103 | 0.219   | 0.229 | 0.208   |
| Wald $\chi^2$         | 4.24E+04 | 0.000 | 2.60E+06 | 0.000 | 7.30E+04 | 0 | 6.10E+05 | 0.000 |

Notes: The $p$-values are two-tailed. Variables are defined in the Appendix and in the notes of Table III.
More importantly, these results represent a further confirmation of Stubben’s (2010) findings on the informative superiority of specific accrual models over aggregate accrual models in detecting a combination of revenue and expense manipulation. Finally, the authors find similar results by repeating the estimations within a matched sample.

5.3.3 Alternative measure of discretionary accruals. In order to test the robustness of the results to alternative measures of accrual management, the authors repeat the estimations of the Equation (7) by using, as dependent variable, discretionary working capital accruals based on the Dechow and Dichev’s (2002) model, which previous studies (e.g. Jones et al., 2008) find to be highly associated with the existence of fraudulent accounting manipulations. In particular, discretionary working capital accruals ($ABSDACC_DD$) are computed as the absolute value of residuals from the following equation, estimated in the same way as Equation (1):

$$\Delta WC = \beta_0 + \beta_1 \frac{CFO_{t-1}}{TA_{t-1}} + \beta_2 \frac{CFO_t}{TA_{t-1}} + \beta_3 \frac{CFO_{t+1}}{TA_{t-1}} + \epsilon_t$$

where $\Delta WC$ is the change in working capital from year $t-1$ to year $t$, and it is equal to accrual variable $ACCR$ of Equation (2) excluding depreciation and amortization expenses. Table VIII shows the results of the estimations with standard errors adjusted by a two-dimensional cluster at the firm and year levels.

The estimated $ABSDACC_DD$ regression is significant at the 0.01 level according to the $\chi^2$ test. Interestingly, the coefficient on variable $LMF_PRECONF$ is positive and significant ($p < 0.01$), consistent with the hypothesis on the more intensive accrual management of LMFs before confiscation relative to LWFs. Conversely, the coefficients on variables
LMF_CONF, LMF_POSTCONF1 and LMF_POSTCONF2 are not significant at conventional levels, suggesting that in the confiscation and post-confiscation years, there is no significant difference in working capital accrual management between LMFs and LWFs. This provides further evidence of the significant impact of the intervention of legal administrators on LMF practices.

It is noteworthy that, unlike ABSDACC_DD regression, the coefficient on variable LMF_CONF is significant ($p < 0.01$) in the previously examined ABSDACC regression, consistent with $H2b$ of this study. This difference between the two regressions may also be due to the fact that working capital accruals of Dechow and Dichev’s model do not include long-term accruals such as depreciation and amortization expenses. This is a further confirmation of the need to examine specific accruals rather than aggregate accruals in order to gain a deeper insight into how accrual management is actually performed.

### Table VIII
Regression of Dechow and Dichev’s discretionary accrual proxy

<table>
<thead>
<tr>
<th>Variables of interest</th>
<th>Coef.</th>
<th>$p$-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>LMF_PRECONF</td>
<td>0.0129</td>
<td>0.000</td>
</tr>
<tr>
<td>LMF_CONF</td>
<td>0.0098</td>
<td>0.213</td>
</tr>
<tr>
<td>LMF_POSTCONF1</td>
<td>0.0012</td>
<td>0.793</td>
</tr>
<tr>
<td>LMF_POSTCONF2</td>
<td>0.0055</td>
<td>0.175</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control variables</th>
<th>Coef.</th>
<th>$p$-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABS ΔNI</td>
<td>0.5728</td>
<td>0.000</td>
</tr>
<tr>
<td>SIZE</td>
<td>-0.0015</td>
<td>0.000</td>
</tr>
<tr>
<td>LEVLONG</td>
<td>-0.0056</td>
<td>0.000</td>
</tr>
<tr>
<td>INVRREC</td>
<td>-0.0014</td>
<td>0.375</td>
</tr>
<tr>
<td>GROWTH</td>
<td>0.0293</td>
<td>0.000</td>
</tr>
<tr>
<td>ROA</td>
<td>0.1434</td>
<td>0.000</td>
</tr>
<tr>
<td>ETR</td>
<td>-0.0015</td>
<td>0.000</td>
</tr>
<tr>
<td>REVTA</td>
<td>0.0028</td>
<td>0.000</td>
</tr>
<tr>
<td>ABMAT</td>
<td>-0.0060</td>
<td>0.000</td>
</tr>
<tr>
<td>LOSS</td>
<td>0.0376</td>
<td>0.000</td>
</tr>
<tr>
<td>SUSPECT</td>
<td>0.0109</td>
<td>0.000</td>
</tr>
<tr>
<td>INDSEC dummies</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>YEAR dummies</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Intercept</td>
<td>0.0426</td>
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</tr>
<tr>
<td>Number of obs.</td>
<td>487,817</td>
<td></td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.3100</td>
<td></td>
</tr>
<tr>
<td>Wald $\chi^2$</td>
<td>1.50E+07</td>
<td>0.000</td>
</tr>
</tbody>
</table>

**Notes:** The $p$-values are two-tailed. Variables are defined in the Appendix and in the notes of Table III.

### 6. Discussion and conclusions
In this study, the authors examine how accounting is used to disguise and carry out Mafia money laundering activities and whether discretionary expense, revenue and aggregate accruals can provide evidence of these illicit practices within a sample of 224 Italian firms, defined as LMFs, due to having been confiscated by judicial authorities because of their owners being accused of Mafia-type association.

Overall, the results reveal that in the pre-confiscation years, LMFs manage aggregate, revenue and expense accruals more than LWFs do, in order to smooth earnings and disguise/carry out money laundering. In the confiscation years, LMFs continue managing accruals more than LWFs do, although for reasons, other than smoothing earnings, which may mostly be linked to accounting restatements, involving accrual reversals, carried out
by legal administrators. In contrast, in the post-confiscation years, there is no significant difference in the level of accrual management between LMFs and LWFs, as evidence of the effective intervention of legal administrators.

This study empirically supports previous qualitative research (e.g. Compin, 2008; Neu et al., 2013) that depicts the role of accounting in masking and allowing criminal practices. In particular, it addresses the need, highlighted by Neu et al. (2013), to better understand how accounting is actually linked to criminal activities. Importantly, the results confirm previous studies on unlisted firms, finding that the use of financial statements in contracting with stakeholders may deter accrual management for opportunistic purposes such as tax avoidance (Klassen, 1997; Beatty and Harris, 1999; Coppens and Peek, 2005). Indeed, the more intensive accrual management within LMFs may be explained by their competitive advantages and market power, arising from the artificial scarcity they create (Champeyrache, 2014), that make their financial statements irrelevant to the determination of the terms of trades with stakeholders. Furthermore, the results are consistent with previous research showing that a low external scrutiny is associated with a higher level of accrual management (Chaney et al., 2011; Duellman et al., 2013; Wongsunwai, 2013). In particular, the ability of LMFs to build networks and relationships within the civil society, the political world and local populations may grant them a protection against authorities’ inspections and interventions.

Previous studies find that several discretionary accrual proxies show significant differences, relative to a control sample, for firms charged by the US Securities and Exchange Commission (SEC) with having committed fraud by overstating earnings (Dechow et al., 1995, 2011; Jones et al., 2008; Stubben, 2010). It is worth noting that these studies mostly employ discretionary aggregate accruals and focus on specifically detected fraudulent manipulations aiming to overstate earnings under specific stimuli and circumstances at certain points in time. On the other hand, in LMFs, the fraudulent purpose can be considered genetic and intrinsic to their existence. Hence, this paper examines LMFs over several years, assuming accrual management to disguise and carry out money laundering, rather than overstating earnings, to be systematically performed for the whole period. Furthermore, the authors analyze both discretionary expense accruals and discretionary revenue accruals in order to provide better evidence of the scope of the manipulations. Therefore, as a further contribution, this study shows that specific accrual models may provide evidence of fraudulent manipulations related to tax avoidance and money laundering as well as to overstatements of earnings.

In addition, this study relieves prior concerns on the ability of discretionary accrual proxies to detect fraudulent accounting manipulations (e.g. Dechow and Skinner, 2000; Jones et al., 2008; Stubben, 2010). Indeed, the detected change of the accrual management pattern, following the reinstatement of the legality pursued by legal administrators after confiscation, suggests the effectiveness of discretionary accrual proxies in providing evidence of fraudulent accounting prior to confiscation. Therefore, discretionary aggregate and specific accrual measures can at least be considered as red flags which could complement other risk indicators of illicit practices in specific socio-economic and political contexts. More specifically, discretionary accrual values may be added to the criteria used by authorities to select firms to be regularly inspected in order to unmask money laundering and tax avoidance practices. Enhancing the efficiency and effectiveness of inspections would strengthen the fight against criminal funding. Furthermore, it would allow authorities to collect additional resources, through the confiscation of criminally derived assets, and finance public policies in economically depressed regions, where criminal organizations find fertile ground. In this regard, Barone and Narciso (2015) document the Mafia’s ability to divert a substantial amount of public funds assigned to poor areas. Moreover, the detection and regularization of LMFs may
restore free competition in the regions where they operate (Fantò, 1999; Arlacchi, 2007) and increase foreign direct investments (Daniele and Marani, 2011), with consequent benefits for the local economy.

However, these findings are subject to several limitations. First, the possibility of a bias in the selection of the sample of LMFs cannot be rejected, considering that undetected and smaller LMFs, unavailable on AIDA, are not analyzed. In addition, there may be selection biases in LMFs prosecuted by judicial authorities. Finally, the measures of accrual management in LMFs greatly depend on the reliability of reported financial statement figures. Indeed, the likely manipulation of these figures and the consequent endogeneity in the calculation models may affect the correct interpretation of the measures. However, the consistent results of the estimations within a matched sample may partially relieve this concern.

The authors envisage some opportunities for future research. First, this study could be replicated in other countries, where money laundering is widespread, in order to determine whether its findings are corroborated in a different context. In particular, previous studies (Forgione, 2009; Roth, 2009; Transcrime, 2013) document the infiltration of the Italian Mafia in the legal economy of several European countries (e.g. Spain, Germany, the Netherlands) and the aforementioned Eurostat (2013) study on money laundering finds that money laundering practices involving firms are widespread across all European countries. Second, additional accrual management proxies and models could be developed and tested in order to consider further specific accruals which may be linked to money laundering activities or other illicit practices. Third, the characteristics and the quality of the audit within LMFs vs LWFs, commonly linked to the firm legal form, could be further explored. Finally, accrual management proxies alongside other variables (e.g. legal and ownership structure, characteristics of shareholders/directors, relationships among shareholders/directors, business networks, political connections) could be included in a logistic model which may contribute to the detection of firms engaging in money laundering activities. In particular, a logistic model would allow considering the predictive power of several additional variables and their association with the aforementioned illicit practices.

Notes
1. The Statutory Financial Statements (both stand-alone and consolidated accounts) are made up of (i) the profit & loss account (ii) the assets and liabilities account (iii) the cash flow statement and (iv) explanatory. Notes: The sub (iii) is mandatory for the statutory financial statements related to the financial year starting from January 1, 2016.

2. The Italian Tax Code (Presidential decree 22, December 1986) sets the derivation principle in the Article 83, stating that taxable income is computed on the basis of the accounting income which should only be adjusted when accounting criteria differ from tax rules. Article 109 of the Italian Tax Code states that expenses must be included in the income statement in order to be considered as tax deductible.

3. The three size limits defined in the Article 2435-bis of Civil Code are: net turnover of €8,800,000; total assets of balance sheet of €4,400,000; and average number of employees in the accounting period of 50.

4. The sample size is acceptable if compared with that of other studies on financial statement fraud (e.g. Beneish, 1997; Jones et al., 2008; Perols and Lougee, 2011).

5. The consulted online newspapers are: Live Sicilia; Stato Quotidiano; La Repubblica; Il Punto a Mezzogiorno; Quodidiano.net; Sciocco News; Il Messaggero; Il Fatto Quodidiano; News.it; Strill.it; Approdo News; Nuova Cosenza; Adnkronos; Gazzetta di Mantova; Il Metropolitano; Il Tirreno; La Stampa; Grandangolo; Palermo Today; Corriere Della Sera.
References


Capacchione, R. (2008), L’oro della camorra, Rizzoli, Milano.


Roth, J. (2009), Mafialand Deutschland, Wilhelm Heine, München.


Further reading


Appendix 1. Definition of variables of the base regression model (Equation 7)

\[ AM_{\text{PROXY}} = SMTH, DACC, ABSDACC, DREVAC, ABSDREVAC, DEXPAC, ABSDEXPAC, ABSDACC_DD, \]

\[ SMTH = \text{earnings smoothing measure as defined in Equation (5).} \]

\[ DACC = \text{aggregate discretionary accruals computed as the residuals from Equation (1).} \]

\[ ABSDACC = \text{absolute value of} \ DACC. \]

\[ DREVAC = \text{discretionary revenue accruals computed as the residuals from Equation (3).} \]

\[ ABSDREVAC = \text{absolute values of} \ DREVAC. \]

\[ DEXPAC = \text{discretionary expense accruals computed as the residuals from Equation (4).} \]

\[ ABSDEXPAC = \text{absolute value of} \ DEXPAC. \]

\[ ABSDACC_DD = \text{discretionary working capital accruals computed as the absolute value of residuals from Equation (8).} \]

\[ LMF_{\text{PRECONF}} = \text{dummy variable taking value of 1 for pre-confiscation LMF years and 0 otherwise.} \]

\[ LMF_{\text{CONF}} = \text{dummy variable taking value of 1 for LMF years in the confiscation year and 0 otherwise.} \]
$LMF_{POSTCONF1}$ = dummy variable taking value of 1 for LMF years in the first year after confiscation year and 0 otherwise.

$LMF_{POSTCONF2}$ = dummy variable taking value of 1 for all LMF years following the first post-confiscation LMF years and 0 otherwise.

$ABS\Delta NI$ = absolute value of change in net income relative to previous year divided by lagged total assets.

$SIZE$ = natural logarithm of total assets.

$LEV_{LONG}$ = long-term liabilities divided by total assets.

$INVREC$ = total inventories and receivables divided by total assets.

$GROWTH$ = change in total assets relative to previous year divided by lagged total assets.

$ROA$ = income before tax divided by total assets.

$ETR$ = current tax expense divided by income before tax.

$REVTA$ = total revenues divided by total assets standardized by industry year.

$ABMAT$ = abnormal material costs computed as the residuals from Equation (6).

$LOSS$ = dummy variable that takes a value of 1 if the firm had two or more consecutive years of negative income including the current and 0 otherwise.

$SUSPECT$ = dummy variable that takes a value of 1 for firm-years with earnings before tax over lagged assets greater than or equal to zero but less than 0.01 and 0 otherwise.

$INDSEC$ = dummy variables representing industry defined by the two-digit SIC code.

$YEAR$ = dummy variables representing the fiscal year.

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Transparency fallacy
Unintended consequences of stakeholder claims on responsibility in supply chains

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Abstract
Purpose – The purpose of this paper is to focus on the research question of how stakeholder claims for transparency work as a means to support responsibility in the international supply chain.
Design/methodology/approach – This theoretical study analyses the relationship between stakeholder claims for corporate transparency and responsible business in the global context, and develops a conceptual model for further theoretical and empirical work.
Findings – The study finds that the call for corporate transparency is insufficient as a means to increase responsibility within international supply chains. The erroneous belief that stakeholder claims for transparency will lead to responsible behaviour is identified as the “transparency fallacy”. The fallacy emerges from the denial of opacity in organisations and the blindness to the conditions of international supply chains (including complexity, distance, and resistance) that work against attempts to increase transparency.
Research limitations/implications – Acknowledging the limits of the transparency mechanism in both management theory and practice is necessary in order to advance responsible business in the international arena. Being conceptual in nature, the generic limitations of the type of research apply.
Practical implications – While acknowledging opacity, corporate managers and stakeholders should focus on changing the supply chain conditions to support responsible behaviour. This includes reducing complexity, distance, and resistance in the supply network.
Originality/value – This study contests the commonly assumed link between corporate transparency and responsibility, and sheds light on the limits and unintended consequences of stakeholder attempts to impose transparency on business organisations.

Keywords Accountability, Corporate communication, Transparency, Stakeholder, Supply chain, Corporate responsibility

1. Introduction
As an outcome of the expansion of the neoliberal political regime, multinational corporations have become the harbingers of global development. In this era of corporate influence, problems of social inequality (Piketty, 2014) and environmental degradation (Intergovernmental Panel on Climate Change, 2014) have been augmented, and continue to worry the citizens of the planet. The increased power of the corporation has not generally resulted in the desired upsurge of responsibility in business organisations. While the modern companies are hesitant to voluntarily accept duties beyond their economic interests, the market mechanism is also shown to have severe limitations in moving organisations and societies towards sustainability (DesJardins, 1998; Heikkurinen and Bonnedahl, 2013). Nevertheless, there are continuous reformist efforts to make the corporation a responsible societal actor and to hold it accountable for its actions.

One of these discourses that seek to align business practices with societal needs (Dahlsrud, 2008) and planetary boundaries (Rockström et al., 2009) takes place under the label of transparency. In fact, transparency of business organisations has become a
twenty-first-century mantra spanning sectorial boundaries. A range of actors tackling issues of sustainable development in the private, public, and third sectors has called for more corporate transparency as a solution to the prevailing unsustainability. Stakeholders of these corporations – including customers, investors, politicians, and non-governmental organisations – increasingly demand more detailed and open disclosure on corporate actions and performance. A common response by corporations has been to publish various types of reports (e.g., Belal and Owen, 2015). Self-reporting, however, has tended to omit to mention negative incidents (Reimsbach and Hahn, 2015), generally lacked credibility, and clashed with external stakeholder accounts (Gallhofer et al., 2006; Boiral, 2013; Rodrigue, 2014). To address these problems, third-party assurance has been offered as a panacea but the robustness, reliability, and consistency of the assurance models have been impugned too (e.g., Ball et al., 2000; Dando and Swift, 2003; Bepari and Mollik, 2016).

Despite these commonly acknowledged challenges, transparency is still considered to be a central tenet in ensuring responsible practice in companies (Dubbink et al., 2008; Mena and Palazzo, 2012) and safeguarding responsibility along supply chains (Doorey, 2011; Egels-Zandén et al., 2015). The rationale behind the call for transparency is that corporate disclosure on environmental, social, and economic performance will lead to more responsible business practices as corporations are exposed to public scrutiny, and can thus be held accountable for their actions. But are these really the outcomes of the transparency claims for responsibility? And can demands for more transparency actually create the needed change towards sustainable development?

In order to gain insights into the possibilities and limits of corporate transparency for sustainability, this paper examines transparency as a mechanism for responsible business behaviour in the global context. Thereby, our analysis zooms into the nature of the interrelation between the concepts of corporate transparency and responsibility in an international business environment. More specifically, the focus of the enquiry is on the research question of how stakeholder claims for corporate transparency work as a means to support responsibility in the international supply chain. The study challenges the often unduly optimistic notion of transparency as a central driver of responsibility for sustainability in business organisations (e.g., Tapscott and Tioll, 2003; Vaccaro and Patiño Echeverri, 2010; Palanski et al., 2011) and supply chains (e.g., Pagell and Wu, 2009; Awaysheh and Klassen, 2010; Doorey, 2011). The study finds that the call for corporate transparency as a means to increase responsibility of international business organisations is inadequate. The paper argues that it would be a fallacy to assume that the stakeholder claims for corporate transparency lead to corporate responsibility in international supply chains. This so-called transparency fallacy is likely to emerge once stakeholders assert that a focal company knows – or even can know – and give a full account of what is going on in and around its supply chains. The degree of transparency achievable is severely hampered by the contemporary supply chain conditions that surround multinational corporations, including the complexity of supply chains, the geographical and cultural distance between the members of those supply chains, and the resistance to transparency measures by suppliers.

We suggest that stakeholder claims for more transparency may even turn out to be counterproductive for enhancing supply chain-wide responsibility, as the demands tend to push firms towards narcissistically praising or defensively palliating and camouflaging their activities by means of empty responsibility narratives. Furthermore, and importantly, the call for transparency may create and uphold myths around multinational corporations being capable of achieving transparency and thus of responsible business conduct. That being so, the requirement of transparency imposed on corporations may also become counterproductive in terms of both stakeholders’ and managers’ time and resources. This paper proposes that developing responsible business behaviour requires both...
stakeholder and corporate efforts be directed towards changing the supply chain conditions that characterise the contemporary global business context.

We draw on the stakeholder approach (Freeman, 1984; Freeman et al., 2010), as well as on streams of accounting and accountability research that problematise various forms of dissonances of corporate action and rhetoric (e.g. Boiral, 2013; Rodrigue, 2014; Moerman and van der Laan, 2015) and explore the thus far relatively uncharted limits and boundaries of corporate transparency and responsibility (e.g. Roberts, 2009; Dingwerth and Eichinger, 2010; Macdonald, 2011). Although a few recent studies have already cast doubts on the assumption that transparency leads unequivocally to more sustainable business conduct (Unerman and Bennett, 2004) and sustainable supply chains (Egels-Zandén et al., 2015; Mol, 2015), so far no direct attempt has been made to conceptualise stakeholder claims as a possible hindrance to responsibility in business. The main contribution of the paper is hence to shed light on the limits and unintended consequences of stakeholder attempts to impose transparency on companies and supply chains. Thus, the theoretical contribution of the paper is two-fold. First, the paper adds to the accounting and accountability literature that emphasises the limits of transparency and accountability (e.g. Roberts, 2009; Messner, 2009; Ioannides, 2012; McKernan, 2012). Second, the paper connects to the sustainable supply chain management literature that far too simplistically sees transparency as the magic bullet, and often advocates external stakeholder pressure as an instrument for pushing supply chains towards greater accountability and sustainability of business practice (New, 2010).

The remainder of the paper is structured as follows. The following section reviews and defines the core concepts of transparency, accountability, and responsibility in the corporate setting, and presents the assumed link between the three. The paper then addresses the various challenges companies face when requested by stakeholders to establish transparency, and the unwanted side effects. The paper concludes that acknowledging the limits of the transparency mechanism is necessary for advancing corporate responsibility in the international business arena.

2. The relevance of transparency in business
In the contemporary global marketplace, the extraordinary power of corporations is widely acknowledged (e.g. Anderson and Cavanagh, 2000; Vitali et al., 2011). The large and successful multinational companies (MNCs), in particular, hold power over their suppliers and possibly even buyers due to their economic volumes (Robinson and Rainbird, 2013). Even decades ago, Galbraith (1973) noted that many business organisations have transformed from “price takers” to “price makers”, a transformation affecting not only the sovereignty of consumers but also the economic system as a whole. These MNCs are found to have both far-reaching opportunities to influence their constellation of network partners (Vitali et al., 2011), and the ability to choose the locations in which they invest and operate (Fuchs and Clapp, 2009). Given their power to also mould lifestyles (Michaelis, 2003) and influence the political and societal arena (Scherer and Palazzo, 2011), they can be seen to be responsible for their business conduct, having both negative duties such as inflicting no harm on their environment and positive duties such as investing organisational resources in shaping a social and institutional setting favourable to sustainability (Macdonald, 2011).

In the network of companies, those that “usually (1) rule or govern the supply chain, (2) provide the direct contact to the customer, and (3) design the product or service offered” are called focal (Seuring and Müller, 2008, p. 1699). Despite their central role in the supply chain, focal companies are not entirely free to do whatever they wish, as active stakeholders (usually customers, state representatives and non-governmental organisations) act as watchdogs when their stakes are at issue (Freeman et al., 2010; Heikkurinen and Ketola, 2012). But for the watchdog mechanism to work, a degree of transparency is needed. For this reason, focal companies are asked, and sometimes required, to disclose not only
their intra-organisational practices but also activities in their supply chains (Islam and McPhail, 2011; Okongwu et al., 2013; Fernandez-Feijoo et al., 2014). Without this disclosure, the stakeholders are unable to assess whether the company’s actions are jeopardising their stakes and if the company is meeting the stakeholders’ expectations in terms of sustainable development, for instance.

In broad terms, transparency refers to openness and the communication of information in such a way that makes it easy for others to see what actions are being performed and which are not. Schnackenberg and Tomlinson (2016, p. 1788) define transparency as “the perceived quality of intentionally shared information from a sender”. In the context of business management, Bushman et al. (2004) define transparency as the availability of firm-specific information to external stakeholders. Recently, there has also been some debate about the rationale for granting stakeholders access to internal business information, including voices that see such access as a human right if it is the precondition of meaningful political participation (Hazelton, 2013). Condensing these definitions, corporate transparency would mean acting in a way that enables others, both internal and external stakeholders, to perceive and understand what the company does, as well as the quality disclosure of the information needed for this, that is, transparency is not merely about sharing information but also about acting transparently.

Nonetheless, corporate disclosure through various forms of reporting is at the centre of the transparency debate (Hess, 2007). According to the framework of the Global Reporting Initiative, as sustainability reporting becomes more and more mainstream for stock-listed companies or companies exceeding a certain size, the issue of lack of credibility moves to the forefront, for example as conceptualised through the reporting-performance portrayal gap (Adams, 2004). And consequently, assurance statements by third parties play an increasingly important role in enhancing credibility (Edgley et al., 2010) despite assurance initiatives at times being criticised for their limited scope, insufficient independence, arbitrary content, and opaque assurance processes (O’Dwyer and Owen, 2005; Gürtürk and Hahn, 2016; Talbot and Boiral, 2015a). In particular, assurance is said to miss the chance of creating further-reaching stakeholder-company dialogue on social and environmental issues (Jones and Solomon, 2010). In any case, mere assurance may be considered inadequate to establish the credibility of corporate communications, especially given that the degree of trust between companies and stakeholders is often low (Adams and Evans, 2004).

More generally, according to Roberts (2009) transparency is intimately connected to accountability in the sense that transparency would be achieved if we could give a full account of ourselves. Accordingly, Harmon (1995, p. 25) states that “accountability refers to an authoritative relationship in which one person is formally entitled to demand that another answer for – that is provide an account of – his or her actions”. Hence, the call for transparency establishes a hierarchical relationship between corporations and their stakeholders with the latter in an authoritative watchdog role. In this respect, Roberts (2009) referring to Althusser (1971) explains the essence of accountability through the metaphor of a street scene where an individual – in our case the company – is hailed by some authoritative force – in our case the stakeholders – “Hey you there!” By answering this call, the company generates narratives that create its identity and through which it gains recognition, that is, the social licence to operate (Mé and Armengou, 2016); simultaneously, however, these narratives are subjected to the judgement of the stakeholders. Thus transparency reveals its ambivalent character as it prompts defensive and self-assertive justification as well as corporate narcissism (Boiral, 2013). Or, as Roberts (2009, p. 958) puts it, “transparency works to advertise an ideal against which we will always fail so that it plays with my fears of being exposed and humiliated whilst at the same time encouraging me to take pride in what is disclosed”.

Transparency
fallacy
3. Corporate responsibility and stakeholders

The contemporary debate on corporate responsibility has attracted a considerable amount of attention among business pundits and academics. It seems that the transformation to sustainable societies is largely dependent on how economic actors, particularly corporations, can be changed towards acknowledging and fostering social and societal value as well as respecting natural capital (Welford, 1997). One could therefore expect companies to consider their operations in order to extend their accountability, from investors and shareholders to a wide range of stakeholders (Adams and McNicholas, 2007). However, there is a conflict inherent in the relationship between responsibility and accountability in a sense that accountability relies on responsibility but the processes of rendering accountability undermine responsibility at the same time; “the processes of accountability draw us […] into explaining and justifying to the community, and thereby it threatens to undo the singularity that is crucial to moral responsibility” (McKernan, 2012, p. 259). Furthermore, the reliable identification of responsible business behaviour on the part of companies remains elusive. For example, if we take the case of Royal Dutch Shell and its oil spills in Nigeria (Pegg and Zabbey, 2013), responsibility remains a vague concept. Is it meaningful to talk about responsible business when an oil company agrees to settle with the local affected community for oil spills and promises to mitigate future risk, but at the same time continues its business activities that deplete fossil fuel reserves and warm the climate at the expense of future generations and the environment? On the other hand, any attempt to offset the harm caused is surely better than nothing but can be considered inadequate to establish responsible conduct. Another more recent case that highlights the problem of the responsible business discourse is Volkswagen’s emission scandal. This German car manufacturing giant was found to cheat with the emissions tests to downplay the real impacts of their vehicles on the environment. Yet, the corporation claims on its website that “social responsibility has long been at the heart of our corporate culture” (Volkswagen, 2015). However, while there are several examples that shed light on malpractice (e.g. Banerjee and Bonnefous (2011) on the French nuclear industry and Owen (2005) on Enron), there are also MNCs that are praised for their excellence, for instance Patagonia (McSpirit, 1999) with its calls for reduced consumption. Whether or not Patagonia has succeeded in actually reducing the overall consumption is another question. The expansion of their manufacturing units has problematically led to increases in both the use of natural resources and the production of climate emissions.

Be that as it may, it is apparent that corporate responsibility, as well as the lack of it, is an empirical phenomenon (Heikkurinen, 2013). Several studies and reports posit that companies take care of the environment and are considerate in sociocultural matters beyond the legal and regulatory requirements (Dahlsrud, 2008). Suggested reasons for these responsibility discourses and practices span mere profit-making (McWilliams and Siegel, 2001), risk management (Bebbington et al., 2008), political ideology (Chin et al., 2013), the new political role of businesses in the globalising world (Scherer and Palazzo, 2011), and the oppression of others (Banerjee, 2007) to the moral high ground (Ketola, 2014) and spirituality (Pruzan, 2008). Owing to the breadth of viewpoints, a precise and all-inclusive definition of corporate responsibility is difficult to establish (for a review see Heikkurinen and Mäkinen, 2016). This paper adopts a definition of corporate responsibility – which comprises corporate environmental responsibility, corporate sociocultural responsibility, and corporate economic responsibility – as “consideration for others, both the salient and fringe stakeholders, including the natural environment and other non-human actors, that is manifested in corporate discourses and/or actions beyond the contextual legal compliance” (Heikkurinen, 2013, p. 33). In this respect, stakeholders are crucial for constituting corporate responsibility; they are the entities to which companies are supposed to respond to and indeed represent the authorities that demand transparency and accountability from
corporations and their supply chains (Roberts, 2009). At the same time, stakeholders are
supposed to create cognitive dissonance among managers and spur change towards greater
accountability of corporate action (Adams and Whelan, 2009).

Freeman (1984) introduced the stakeholder approach to managing a business
organisation successfully, which has now become popular and broadly utilised in studies
of corporate responsibility (Dahlsrud, 2008). According to this approach, a stakeholder is
defined as “any group or individual who can affect or is affected by the achievement of the
organization’s objectives” (Freeman, 1984, p. 46), and the consideration of the expectations
of both primary (e.g. customers, communities, employees, financiers, or suppliers) and
secondary stakeholders (e.g. government, competitors, consumer advocate groups, special
interest groups, or the media) is considered to be the key to economic success and survival of
the company (Freeman et al., 2007, 2010). Hart and Sharma (2004) underline that the groups
at the fringe of a firm’s operations (i.e. the poor, weak, isolated, non-legitimate, and even
non-human stakeholders) also matter, as they possess knowledge important to the
organisation. A stakeholder analysis is presumed to contribute to maximising both
shareholder value (Mitchell et al., 1997) and “competitive imagination” (Hart and
Sharma, 2004), as well as to connect business to ethics (Freeman et al., 2010). Nevertheless,
from a viewpoint of inclusive, responsible business, a challenge inherent in the stakeholder
approach is selecting those stakeholders whose concerns matter in business decisions, to
weigh the concerns of stakeholders and the business in cases of conflicts of interest, as well
as to distinguish real response to manifested stakeholder expectations from merely
ostentatious activities that may be labelled as so-called impression management
(Clatworthy and Jones, 2006; Merkl-Davies et al., 2011; Guillamon-Saorin et al., 2012).

The stakeholder approach prescribes that the main goal of corporate responsibility is to
create value for key stakeholders and fulfil responsibilities to them (Freeman and
Velamuri, 2008). These key stakeholders are often the most powerful, not the stakeholders at
the “fringe”, such as local communities, animals, or the unborn. “To achieve greater
consensus […] all stakeholders (both economically powerful and economically weak) need
to more readily engage in open, honest and cooperative discourse, being prepared to
acknowledge and accept the force of the stronger argument and modify their views
accordingly” (Unerman and Bennett, 2004, p. 703). Such a discourse could, for example, be
led by dialogic accounting techniques that aim at breaking the predominance of shareholder
interests and drives stakeholder accountability and ecological sustainability (Brown, 2009;
Brown and Dillard, 2015; Brown et al., 2015). But even if the stakeholder approach is as
inclusive and democratic as theoretically possible, for example by harnessing the use of
social media for engaging stakeholders in continuous exchange (Manetti and Bellucci, 2016),
the non-human environment and the needs of future generations are likely to remain
under-represented, as these stakeholders have no direct voice (Anderson et al., 2012).
Moreover, a firm managed in accordance with the stakeholder approach does not, and
indeed cannot, acknowledge the intrinsic value of its stakeholders in its decision making.
Thus, the responsibility for an action becomes narrowly measured merely in terms of its
utility. This illustrates that while the engagement of stakeholders is related to corporate
responsibility, it neither signifies nor equates to corporate responsibility (Greenwood, 2007).
As Greenwood (2007, p. 31) notes: “Stakeholder engagement may or may not involve a moral
dimension and, hence, is primarily a morally neutral practice”.

4. Transparency in international supply chains
As a growing part of the overall impact of a company stems from purchased materials and
primary production, the need for transparency has increasingly been extended beyond the
narrow confines of the company to embrace its direct suppliers, or even the whole
supply and distribution chain (Egels-Zandén et al., 2015; Mol, 2015; Godar et al., 2016).
Egels-Zandén et al. (2015, p. 95) define supply chain transparency as the “disclosure of information about supplier names, sustainability conditions at suppliers, and buyers’ purchasing practices”. The importance of transparency for stakeholders is repeatedly underlined in the scholarly debate (e.g. Doorey, 2011). Transparency is supposed to rebalance the power asymmetry between a company and its stakeholders in favour of the latter; hence, by demanding transparency stakeholders hold corporations accountable for their behaviour (Dingwerth and Eichinger, 2010). Ultimately, the goal is to globally uphold at least a minimum set of social and ecological standards (Chan and Ross, 2003).

However, transparency is not necessarily always beneficial for actors in civil society. Mol (2015), for instance, raises a concern that companies could abuse their powerful position within society for hijacking the notion of transparency in order to monitor the environmental impacts and resource use of consumers, hence reversing the direction of information disclosure and the hierarchical relationship and putting companies into the authoritative position of demanding transparency and hence accountability (cf. Roberts, 2009). For example, companies may use smart utility metres for creating detailed patterns of water and electricity consumption of citizen-consumers, price reduction card systems for monitoring individual shopping behaviour, or health and safety provisions for increasingly controlling workers in factories (Mol, 2015).

Furthermore, reporting through the quasi-standard guidelines of the Global Reporting Initiative has failed to shift power in favour of civil society and the non-human world. According to Dingwerth and Eichinger (2010), transparency policies persist despite their failure to empower stakeholders by their function of “coping”; the policies somehow manage the inert and difficult to change fundamental issue of irresponsible production and consumption patterns of modern societies without actually resolving it.

Although there is some reason behind transparency neither effectively empowering stakeholders nor guiding companies towards assuming greater responsibility, focal companies have much at stake when stakeholders push them towards assuming responsibility for their supply chains: brand reputation, further investment, and the likelihood of governmental action, to name just a few. In fact, there is often a clear business case for focal companies to take instances of non-compliance on the part of their suppliers seriously, especially in cases when there is a risk of provoking campaigns by critical stakeholders (e.g. environmental activist groups) that can be further fuelled by the media (Deegan and Islam, 2014). There are abundant examples of corporations being blamed for their suppliers’ operations and business practices with adverse impacts. For example, Nestlé was blamed for rainforest deforestation, Nike for child labour, Apple for sweatshop work conditions, and Mattel for the use of toxic materials (Wolf, 2014). However, even if transparency and visibility is assumed to be one of the key aspects of supply chain management (e.g. Carter et al., 2015) and sustainable supply chain management (e.g. Pagell and Wu, 2009; Busse et al., 2017), it is obviously exceptionally difficult for companies to deliver transparency throughout their supply chains.

One main reason for this is that in the contemporary economic system, international supply chains are extremely complex and constantly changing: “Companies operate in an increasingly complex world: Business environments are more diverse, dynamic, and interconnected than ever – and far less predictable” (Reeves et al., 2016, p. 46). While spatial and temporal dynamism is an unavoidable state of affairs (made famous by Heraclitus’ of Ephesus notion that “You could not step twice into the same river”), complexity mainly derives from multiple supplier tiers (Hartmann and Moeller, 2014) and second- and third-tier suppliers that are often beyond the comprehension and the control of the focal company (Wilhelm et al., 2016). Extending supply chains towards the notion of supply networks points to the multitude of suppliers on each supplier level and how the arrays of suppliers are intertwined. Some of the largest companies in the world have tens of thousands of
organisations in their production and distribution networks making the transactions and other activities very hard to manage, or even count. Indeed, in these cases, it is almost impossible for focal companies to develop adequate control mechanisms and to build up the trusting relationships that safeguard supplier and distributor cooperation, which is necessary to encourage responsible business behaviour throughout the supply chain (Das and Teng, 1998). Nevertheless, Chen and Paulraj (2004) see supply chains as “the challenge of designing and managing a network of interdependent relationships developed and fostered through strategic collaboration” (p. 119). While the collaborative approach emphasises the value added through an inter-organisational combination of resources eventually leading to inter-organisational competitive advantage (Gold et al., 2010), it scarcely reflects the phenomenon of extensive value capture by the downstream actors (often in the northern hemisphere) to the detriment of the upstream actors (often in the southern hemisphere) (Gold et al., 2017). The complexity of international supply chains is thus not limited to the amount of transactions and subcontracting, but also extends to cover the multifaceted nature of power dynamics (Schleper et al., 2017). This unequal power distribution along the chain is particularly evident for example in the cases of international food (Johannessen and Wilhite, 2010) and textile (Perry and Towers, 2013) supply chains.

Moreover, while research on international supply chains has traditionally tended to focus on the vertical (mostly buyer-seller dyads), recent studies have also explored the horizontal dimension of supply chains (e.g. Neilson and Pritchard, 2010; De Neve, 2014; Silvestre, 2015). The horizontal dimension embraces the formal and informal institutional contexts (cultural, legal, political, etc.) that shape production processes and labour conditions along international supply chains. While the local values and norms may collide with the values and norms of focal companies (and standard-setting international bodies such as the United Nations) or of other organisations in the vertical dimension, the collision of cultural preferences and the related complexities often remain hidden (see Lund-Thomsen, 2008). It is apparent how the specific local embeddedness of production (and servicing) processes along international supply chains has been neglected since the development of swift and cheap transport abetted the illusion of homogeneous production in the global marketplace. Be that as it may, it is clear how local political, linguistic, social, and cultural differences add to the complexity of international supply chain management that firms face while aiming to establish responsible supply along their chains (Pedersen and Andersen, 2006).

5. Identifying the transparency fallacy

When external stakeholders, including consumers, insist on corporate transparency as an expression of corporate responsibility, they are likely to be taken in by the transparency fallacy. This fallacy is an erroneous belief that stakeholder claims for corporate transparency will lead to increased corporate responsibility in international supply chains. This misbelief is founded on an assumption that a business organisation operating with international supply chains is, or could become, transparent in its operations. In other words, there is a denial of opacity in organisations. And certainly, the more complex and multifarious the business organisation is, the greater the degree of opacity. Owing to the dynamic complexity of international and multicultural supply chains – encompassing the sourcing, primary production, manufacturing, distribution, retailing and consumption of goods, and services – as well as the geographical and cultural distances between the members of those supply chains, focal companies could be regarded as systematically unaware of what they are “orchestrating”. This is reflected in a more general argument of opacity that is part of every individual – and hence also every organisation – and which cannot be accounted for: “Therefore, I cannot explain everything I have done, and I cannot tell a coherent story of who I am and what I have experienced because my experience and conduct have not been motivated exclusively by my conscious efforts and deliberations.
and because the minutiae and complexity of what happens will often exceed my recognition
and memory” (Messner, 2009, p. 925). This opacity in organisations implies that focal
companies are not able to give a full account of the practices within their supply chains,
even if they hold an extraordinarily powerful position therein, since they even cannot give
full account of their own organisational practices. By stating that companies do not, and
even cannot, have full information about production conditions in their supply chains, we by
no means wish to imply that companies are always eager to know about those issues, or
would always act differently even if they knew how things really are. Rather, we intend to
show how the stakeholder claims for transparency influence business activities and, in
particular, the implications for corporate responsibility.

According to the logic of the stakeholder approach (Freeman, 1984; Freeman et al., 2010),
when pressured by external stakeholders who threaten to substantially tarnish their brand
reputation, to facilitate adverse government intervention or to deter investors, focal
companies have to take their stakeholders’ concerns very seriously. When their
stakeholders lobby for transparency in a firm’s supply chain which that firm cannot
easily (and certainly not fully) provide, such companies tend to take transparency claims
literally and generate narratives to avoid blame (Hood, 2007). Such narratives may be
abundant in length but usually do not capture the essence of the circumstances and
activities in the upstream production. In this sense, companies are prone to generate an
illusion of transparency; by trying to make the invisible visible companies might just create
“more information, less understanding, and in particular more information, less trust”
(Strathern, 2000, p. 313). Aiming to satisfy the manifested stakeholder expectations,
corporate management might feel forced to engage in the so-called impression management.
At a minimum, the stakeholder claims for transparency encourage managers to develop
narratives about corporate performance that over-emphasise good news and downplay
bad news, in other words, managers engage in impression management by means
of enhancement (Clatworthy and Jones, 2006; Merkl-Davies et al., 2011; Guillamon-Saorin
et al., 2012). This image-enhancement strategy also refers to the discourse on corporate
transparency itself, meaning that corporations present themselves as transparent or on a
route to transparency. Previous research also showed that these narratives can become even
more extensive and cognitively more complex if companies face negative organisational
outcomes or allegations which cause them to take refuge in retrospective sensemaking
(Merkl-Davies and Brennan, 2011). Moreover, Boiral (2016) found that when companies face
stakeholder claims regarding socially sensitive issues, they may legitimise their impacts
through the use of various rhetoric techniques of neutralization (Talbot and Boiral, 2015b).
This is in particular the case if the issue at hand may be seen as non-measurable and
potentially unaccountable, such as the specific impacts of mining companies on biodiversity
(cf. Jones and Solomon, 2013; Tregidga, 2013). Such techniques of neutralization involve
various forms of justification and various degrees of recognition of negative corporate
impacts. Mining companies may simply deny significant negative impacts on biodiversity;
distance themselves from self-reported negative impacts by contextualising and relativizing
them, and by highlighting uncertainties as well as the legality of corporate operations; claim
an overall positive or at least neutral impact; or dilute own responsibilities by pointing to
other actors or adverse circumstances (Boiral, 2016).

These impression management techniques – of which the aforementioned ones of image-
enhancement, retrospective sensemaking, and neutralization are only examples – increase
the amount of corporate narratives without contributing to genuine transparency of
business conduct. In fact, the aim of corporate transparency clashes with the empirical
phenomenon that business operations have been and are still becoming more global: with
greater reach, the complexity of supply chains keeps increasing and the possibility of
transparency continues to decrease. From the value creation perspective of the stakeholder
approach, such strategically optimised, somewhat hollow narratives may not be problematic, as they can contribute to maximising shareholder value and even meeting the expectations of the most salient stakeholders. False transparency narratives, however, may be neither a satisfactory means nor an end to connect business and ethics for the goal of sustainable change. They cement the status quo and represent indeed a step backwards in the quest for new forms of accounting, reporting, and accountability that a sustainable world would require (Atkins et al., 2015).

This mechanism of stakeholders lobbying for transparency from a position of authority and corporations responding through narratives of responsibility that prove rather elusive then perpetuates itself. On the one hand, accountable corporations – corporations that accept accountability or on which accountability is imposed – can no longer escape the logic of accountability; “once I account, I have entered the logic of accountability, implicitly agreeing that there is a legitimate need to give an account” (Messner, 2009, p. 927). The accountable company is condemned to fail in the eyes of the critical stakeholders, no matter whether it narcissistically praises or defensively camouflages and palliates its (supply chain’s) business conduct; in this respect Roberts (2009, p. 958) reveals the terrifying nature of transparency as an “ideal against which we [multinational corporations] will always fail”. On the other hand, stakeholders are largely unaware that it is indeed their relentless demands for transparency that increasingly push companies towards creating narratives which lay a smokescreen for corporate irresponsibility. These demands persuade companies to enhance, repair, and defend their narcissistic self-image and thereby prevent corporate self-reflection, and block a company acquiring insights into its own incoherent narratives and imperfections and a beneficial attitude of learning (Roberts, 2009), which would bring corporations back on track to genuinely assuming greater responsibility towards society and the natural environment (Atkins et al., 2015).

6. Discussion

The stakeholder approach to business and society relationships implies that consumers, NGOs, and other stakeholders adopt a watchdog role to contain corporate irresponsibility that puts their interests at risk (Heikkurinen and Ketola, 2012). In order to fulfil this role and to serve as a counterweight to corporate power, stakeholders urge corporations and their associated supply chains to be transparent (e.g. Dingwerth and Eichinger, 2010; Fernandez-Feijoo et al., 2014; Garcia-Sanchez et al., 2014). This lobbying for corporate transparency suggests that stakeholders are taken in by the transparency fallacy, the erroneous belief that large companies, and their supply chains, can become sufficiently transparent and that this transparency will lead to corporate responsibility. In trying to impose comprehensive accountability on internationally operating focal firms, consumers and other stakeholders tend to neglect that many corporate managers lack knowledge of and control over their suppliers’ transactions (beyond the first tier, certainly) owing to supply chain complexity (Hartmann and Moeller, 2014), resistance from suppliers, and the diversity in terms of sociocultural embeddedness of supplier behaviour (Schleper et al., 2017).

By pushing for transparency, stakeholders might also be disregarding the point that there will always be some opacity (Messner, 2009) within every organisation, and great degrees of opacity in the global production chains and networks. Hence, there is a compelling argument that focal, MNCs and their management cannot give a full or a sufficient account of their own actions. Yet stakeholder demands impose the logic of accountability on the focal firm according to which an organisation “cannot not account” since even a “denial to give an account may be interpreted as an account” (Messner, 2009, p. 927), despite all the actual limits to (supply chain) accountability and therefore transparency outlined above. In fact, the demand for transparency establishes an authoritative relationship (Roberts, 2009) between stakeholders and corporation that tends
to encourage companies to justify and camouflage their activities defensively or present a flattering image of their conduct in order to acquire admiration and recognition (Boiral, 2013). In any case, stakeholder claims for transparency push corporate managers towards generating narratives that create a mere illusion of transparency (Strathern, 2000), guided by various forms of impression management (Clatworthy and Jones, 2006; Merkl-Davies et al., 2011; Guillamon-Saorin et al., 2012).

Owing to the limits of knowledge and control, as well as the concept of transparency, these narratives about responsibility – no matter whether inclined towards blame avoidance or self-praise, or both – are unlikely to satisfy critical stakeholders in their alleged authoritative position. It may be noted here that this more or less commanding position does not automatically grant access to the independent information crucial for verifying company accounts (O’Sullivan and O’Dwyer, 2009), such as counter-accounts and shadow accounts authored by third parties (Gallhofer et al., 2006; Cooper et al., 2011; Boiral, 2013). Uninformed and dissatisfied stakeholders will thus call for amendments to corporate accounts and companies will have to respond although it is quite unlikely that providing more or “better” company disclosure could solve the problem at hand. It hence now becomes clear that these stakeholder demands for transparency – together with the intrinsic necessity for companies of not meeting them – are the starting point and the perpetuating mechanism of the transparency fallacy by which stakeholders are easily taken in (Figure 1).

Figure 1 illustrates the process of the so-called transparency fallacy (the dotted arrows in the model) that falsely assumes that stakeholder demands for corporate transparency lead to responsible behaviour on the part of corporations in the international supply chain. This paper has argued that stakeholder claims for transparency lead to responsibility narratives, rather than actual responsible behaviour owing to the general opacity in organisations and the prevailing supply chain conditions. Examples of such conditions are high levels of complexity (characterised by an extensive, dynamic supply network where parts interact with other parts in multiple ways), high levels of distance between actors (in geographical, linguistic, and cultural terms), and high levels of resistance within the supply chain (by suppliers and other stakeholders).

The transparency fallacy that is blind to both opacity and the role of the supply chain conditions is detrimental to companies, as well as to society and the environment, as it wastes the resources of stakeholders and businesses. The time and energy used to provide all the supplier checks and assurance mechanisms appears – based on our analysis – to be largely in vain if they do not substantially change contemporary supply chain conditions. The blind pursuit of transparency may even do a disservice to the cause of responsibility and hence sustainable development. For instance, organisations and their stakeholders being kept busy seeking better technical solutions and auditors’ reliability checks may be distracting attention from the fundamental lack of responsibility of certain business conditions.
practices themselves. For example, in the case of Royal Dutch Shell, the unsustainability of the whole fossil fuel industry is not the centre of attention, as it perhaps should be if we are really serious about reducing CO₂ emissions globally. Even if oil companies could be compelled to provide increased transparency of their corporate conduct, it would not change the fact that fossil fuel corporations belong to the past (as the label already suggests) if climate change is to be tackled. It is important to note here that a transparent act does not alone denote that it is ethically sound: it is just a more visible act.

Making the notion of transparency a meaningful and more effective concept will require that the mechanism of the transparency fallacy be dismantled. On the one hand, this might be accomplished by proactively accepting the limitations of accountability and transparency, aiming for “humility and acceptance in relation to the [imperfect] self and generosity in relation to similarly limited others” (Roberts, 2009, p. 967). Acknowledging the limits of accountability can indeed be liberating and beneficial for ethical business conduct since “making people accountable may easily turn into a blame game that can effectively impede us from assuming our collective responsibility for problems that affect us all” (Messner, 2009, p. 936), such as various kinds of sustainability-related problems. In the context of international supply chains, this would also mean releasing stakeholders from their watchdog function to some extent (Heikkurinen and Ketola, 2012), so that companies can once again internalise moral responsibility for their actions (Joannides, 2012) towards social and ecological systems. In this way, communication and interaction with stakeholders would no longer be any threat to companies, but would instead help develop the corporate capability for reflection, which stimulates organisational learning (Roberts, 2009).

On the other hand, the dismantling of the transparency fallacy necessitates more focus on the supply chain conditions that surround multinational business organisations. The prevailing supply chain conditions (e.g. complexity, distance, and resistance) are working against attempts to improve transparency. On the level of supply chain design, this signifies that transparency could be fostered by reducing the complexity and distance of the economic organisation to a comprehensible state, as well as forming chain constellations and business operations that provoke less resistance from the suppliers. In practice, this would mean bringing the locations of consumption and production closer to one another, in other words, shortening the supply chain. In this kind of simpler and more local business setting, stakeholders would then be better able (in relative terms) to perform their role of watchdogs, if such a role remains necessary. The suggestion of downsizing the economy’s complexity by approximating the locations of consumption and production is a current trend in supply chain management termed “re-shoring” (e.g. Gray et al., 2013). The notion of a more local economy has also received support from several economists, most notably from Schumacher (1973), Georgescu-Roegen (1975), Daly (1992), and Latouche (2007), as well as the local produce movement (Norberg-Hodge, 1999; Bauermeister, 2016).

The current research being purely conceptual in nature makes it subject to the generic limitations of such research, above all the missing empirical corroboration of the mechanism of the transparency fallacy proposed. Despite this limitation, the paper makes various contributions to the knowledge base and will guide follow-up empirical research in the research streams of accounting and accountability as well as sustainable supply chain management. The paper contributes to explaining the widespread empirical phenomenon of a mismatch between corporate disclosure and action that has been repeatedly addressed in accounting and accountability research (see e.g. Boiral, 2013; Rodrigue, 2014; Moerman and van der Laan, 2015). It warns against over-emphasising the watchdog role of stakeholders intended to make companies behave more responsibly and sustainably, and instead calls for greater emphasis on the influence of the ethics of the organisation and the supply chain conditions that shape corporate behaviour. At the same time, the study questions a central tenet of sustainable supply chain management research, that is, the assumed causal...
link between supply chain transparency and the triple bottom line (i.e. social, environmental and economic) supply chain performance (e.g. Pagell and Wu, 2009; Awaysheh and Klassen, 2010; Doorey, 2011). Thereby, without advocating supply chain secrecy (Mol, 2015), we add to the few supply chain studies that cast doubts on whether transparency within supply chains is always achievable and whether the transparency discourse is always desirable or beneficial to the consumers and society at large (Égels-Zandén et al., 2015; Mol, 2015). Simultaneously, we extend the body of research that explores the limits of accountability and transparency (e.g. Roberts, 2009; Messner, 2009; Joannides, 2012; McKernan, 2012) into the specific context of international supply chains, and we provide an argument for the localisation of production and consumption practices.

7. Conclusion
This paper has critically examined corporate transparency as a mechanism for responsible business in the global context. The focus of the enquiry was on the research question of how stakeholder claims for transparency work as a means to support corporate responsibility in the international supply chain.

The short answer is “poorly”. The study suggests that, in the context of complex international supply chains, the call for corporate transparency may not be serving its purpose of holding companies accountable for their social and environmental impacts, and fostering responsibility behaviour. On the contrary, the study finds that the call for corporate transparency is an inadequate means to increase responsibility in business, and suggests that it is a fallacy to assume that stakeholder demands for corporate transparency lead to corporate responsibility in international supply chains. This process is hindered by general opacity in organisations as well as the contemporary supply chain conditions, such as complexity, distance, and resistance.

The analysis also points to the limitations of the corporate responsibility model, which is mainly driven and enforced by the external stakeholders of the corporation, and calls for a more critical research agenda that incorporates structural and ethical aspects in investigating transparency and responsibility in supply chains. That is, rather than uniformly and merely calling for more transparency, both scholars and public and private decision makers could draw careful attention to the limits of transparency and accountability ideas, to the specific conditions that surround firms in the international business arena, and to the question of which structural factors (including complexity, distance, and resistance) may prevent attempts to increase transparency throughout supply chains. The effects of transparency on corporate social and environmental sustainability need to be further critically scrutinised by follow-up studies that complement conceptual reasoning with empirical research designs.

As our paper suggests, the straight causal link may be deliberately questioned and replaced by more differentiated, contingent, and dynamic inter-relationships between transparency and responsibility as well as sustainability, also considering potential unwanted side effects of treating transparency as a panacea for irresponsible and unsustainable corporate business practice. Accounting and accountability research may further theorise about reasons and implications of a mismatch between corporate disclosure and action, for single companies and extended towards supply chains. At the same time, new accounting frames and techniques may be explored to support sound forms of corporate accountability and make companies internalise moral responsibility, by discouraging corporate behaviour that is largely symbolic and superficial and making companies actively engage beyond their own operations. Furthermore, while singling out companies and industries and demonstrating their irresponsibility can help draw attention to examples of concern, there is a dire need to critically evaluate the potentials and pitfalls of the economic system as a whole, as well as the institutions and ideologies that continue to produce and support the irresponsible corporate behaviour in question.
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Stakeholder engagement in sustainability accounting and reporting

A study of Australian local councils

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Abstract

Purpose – The purpose of this paper is to examine how stakeholders are engaged in the sustainability accounting and reporting processes of Australian local councils.

Design/methodology/approach – Managerial stakeholder theory through the use of the notion of stakeholder salience provides a theoretical basis for exploring stakeholder engagement in the sustainability accounting and reporting process. Case study research was used to explore the stakeholder engagement practices of three Australian local councils. Data collection methods included interviews and document analysis.

Findings – The findings of this research identified the importance of stakeholder engagement in the entire sustainability accounting and reporting process, the development of strategic plans and sustainability indicators, the measurement of sustainability performance and the preparation of sustainability reports.

Research limitations/implications – This study, by integrating the sustainability accounting and reporting literature with the stakeholder salience concepts of power, legitimacy, urgency and proximity, illustrates the critical role of stakeholder engagement in the sustainability accounting and reporting process of three local councils.

Practical implications – This study has implications for public sector organisations (PSOs) and their stakeholders in relation to stakeholder engagement in sustainability accounting and reporting. The findings of this study will also be useful to corporations in understanding the importance of stakeholder engagement in sustainability accounting and reporting.

Social implications – The public sector is expected to be a leader in sustainability and this paper provides evidence of three councils who through their stakeholder engagement provide exemplars of useful practices that could be adopted by other entities.

Originality/value – Prior research in PSOs has primarily focused on the sustainability accounting and reporting process but has given limited consideration to the involvement of stakeholders. The focus on stakeholder engagement through the use of managerial stakeholder theory extends the role of stakeholders from merely being an audience for sustainability reports to an influential contributor in the sustainability accounting and reporting process.

Keywords Stakeholder engagement, Stakeholder theory, Social, Environmental, Local councils, Sustainability accounting and reporting

Paper type Research paper

1. Introduction

The involvement of stakeholders in the accounting and reporting process enables organisations to identify and incorporate their material concerns, issues, perceptions, needs and expectations (ACCA, 2005; Bebington et al., 2007; Fries et al., 2010; GRI, 2013; AccountAbility, 2015). Stakeholder engagement as defined by AccountAbility (2015, p. 6) is:

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responsiveness, transparency and accountability (Brown and Hicks, 2013; GRI, 2013) and establishes closer ties to stakeholders interested in sustainability performance (Hörisch et al., 2015).

Although prominent accountability frameworks, such as GRI (2013) and AccountAbility (2015), have recognised stakeholder inclusivity as the core principle to enhance accountability and transparency of sustainability issues, limited empirical studies have been undertaken to explore stakeholder engagement practices (Gao and Zhang, 2001; Unerman, 2007; Rinaldi et al., 2014; Hörisch et al., 2015). Little research has been undertaken on the issues related to essential aspects of stakeholder engagement such as the means used by organisations to build relationships with stakeholders and the approaches adopted by organisations to engage stakeholders (Gao and Zhang, 2001; Unerman, 2007; Rinaldi et al., 2014) and the impact of stakeholder engagement on the strategic planning and reporting process (Burchell and Cook, 2006). This paper aims to respond to some of these gaps in the literature by examining the nature and role of stakeholder engagement in the sustainability accounting and reporting processes in local councils. The central research question is:

RQ. What is the role of stakeholder engagement in the sustainability accounting and reporting processes of Australian local councils?

The public sector is chosen as the research context because of the increasing critical role of public finances, accountability and governance in this sector (Lapsley and Skærbæk, 2012; Pilcher, 2014) which extends to sustainability performance and accountability (Ball and Grubnic, 2007; Ball et al., 2014). Emphasis is on local councils because this level of governance is closest to the community and more specifically the individual, and therefore has a critical role in educating and responding to the local community for promoting sustainability in the local area (Sitarz, 1993). The Australian public sector has been selected for this study because it has shown a steady increase in sustainability accounting and reporting practices in recent years in comparison to public agencies in the USA, UK, Canada, Hong Kong (Lamprinidi and Kubo, 2008) and Japan (Burritt et al., 2009). Sustainability reporting in Australian local councils is influenced by both mandatory and voluntary reporting practices. For example, local councils in New South Wales (NSW) are required to prepare mandatory State of the Environment (SoE) reports under section 428A of the Local Government Act 1993. The local councils in other Australian states make voluntary disclosures on social and environmental issues. Considering that stakeholder engagement is critical to sustainability accounting and reporting in local councils, the primary objective of this research is to explore its role in the sustainability accounting and reporting practice of Australian local councils. This focus involves seeking information on the factors that can accelerate the sustainability accounting and reporting process and stakeholder engagement practices in specifically local councils and more generally in the public sector.

2. Stakeholders, engagement and stakeholder theory

Freeman (1984, p. 46) defines stakeholders as “any group or individual who can affect or are affected by the achievement of the organisation’s objectives”. This definition indicates the existence of a two-way impact relationship between an organisation and its stakeholders. First, stakeholders can affect organisational goals which implies that organisational performance can benefit from the activities and participation of its stakeholders (Gao and Zhang, 2001). This impact legitimises stakeholder engagement in decision making to achieve the best possible organisational performance. Second, stakeholders are affected by the achievement of organisational goals and this impact legitimises a stakeholder’s right for stakeholder engagement (Gao and Zhang, 2001). The inclusion of a broad range of stakeholders enables organisations to recognise and address their social and environment
impacts (Hörisch et al., 2014). The pressure to communicate more proactively and more frequently with stakeholders demands an engagement with a diverse range of stakeholders through enhanced inclusiveness, partnership and dialogue (Andriof et al., 2003; Crane and Livesey, 2003). Organisations often do not deal with stakeholders on an individual basis, they address the demands of multiple stakeholder groups (Andriof et al., 2002, 2003).

In order to recognise and address stakeholders’ needs and expectations, Reed (1999) categorises stakeholders into internal and external groups. The internal stakeholders are those groups who work within organisations and have formal, official or contractual responsibilities. Some examples of internal stakeholders include employees and managers. On the other hand, external stakeholders are those individuals and groups that are not employed by an organisation but affect or are affected by the organisation’s activities. These stakeholders include customers, government and the local community. This classification is useful when examining the nature of contributions made by internal and external stakeholders in the accounting and reporting process.

Since the early 2000s, stakeholder perceptions have changed dramatically from “inform me” to “engage me” to incorporate dynamic stakeholder needs and expectations in decision making (Cummings, 2001; Andriof et al., 2002). This shift requires organisations to understand and address stakeholder concerns through proactive engagement approaches such as partnerships and collaborations (Andriof et al., 2002, 2003). There has been increased emphasis on engaging stakeholders to align mutual interests and to advance social and environmental performance, including incorporating the views of stakeholders in the sustainability accounting and reporting process (Unerman, 2007; GRI, 2013; Rinaldi et al., 2014; AccountAbility, 2015).

“Stakeholder engagement exercises, where organisations and stakeholders interact, are promulgated as processes enabling stakeholders to have a ‘say’ in organisational decisions impacting on their lives” (O’Dwyer, 2005, p. 28). The two-way communication not only allows organisations to listen, share and consult with their stakeholders on critical issues (Cummings, 2001) but also contributes to education as well as training and information in relation to internal and external stakeholders involved (Brown and Hicks, 2013). Constructing and implementing successful dialogue encourages both organisations and stakeholders “to engage more often in the difficult, but productive, task of listening to and learning from each other” (Lawrence, 2002, p. 199). Different stakeholder groups such as non-government organisations (NGOs), community groups and public sector organisations (PSOs) possess knowledge and technologies beyond the reach of an organisation and engaging with such groups assists the organisation to gain knowledge previously unavailable to it (Burchell and Cook, 2006).

Although stakeholder engagement emphasises active participation and knowledge sharing, there are some issues and difficulties that can affect its quality and outcomes. These issues and difficulties include conflicting interests between an organisation and its stakeholders, heterogeneous expectations of stakeholders, difficulty in negotiating a consensus and the impossibility of direct dialogue with certain stakeholders such as future generations (Thomson and Bebbington, 2005; Unerman, 2007; Rinaldi et al., 2014). Some research studies show that the existing stakeholder engagement practices of PSOs as well as corporations are ineffective because these ignore or misstate stakeholders’ concerns, especially when they are powerless. Archel et al. (2011, p. 340) examined government-led corporate social responsibility initiatives in Spain and found that stakeholder dialogue in this initiative was limited to “a symbolic, legitimating function, even though it was itself characterised by dissonance and conflict”. Barone et al. (2013) also indicated the existence of tokenism in stakeholder engagement undertaken during a major corporate takeover. They found that the company’s efforts to engage with stakeholders were limited to managing reputation as there was lack of direct communication with less powerful but key
stakeholders such as local community. Nevertheless, Rinaldi et al. (2014) reinstate the need to develop and employ democratic dialogue mechanisms to empower a broad range of stakeholders in order to contribute effectively to sustainability practices, including sustainability accounting and reporting.

Stakeholder theory has been at the core of sustainability accounting and reporting research as it emphasises the broader accountability of organisations. This theory asserts that accountability of organisations goes beyond rendering accounts to shareholders and includes all individuals and groups that are affected by their decisions. It provides useful insights to understand how various stakeholders can be involved in organisational activities and decisions. The theory has three variants: managerial/descriptive, normative and instrumental (Donaldson and Preston, 1995).

The focus in this paper is on the managerial stakeholder theory. The critical issue that is of relevance for the current study is the role of stakeholder engagement in the sustainability accounting and reporting process. This requires an understanding of how and to what extent stakeholders are engaged by local councils. Consequently, the managerial stakeholder theory offers a useful framework as it focuses on stakeholders’ influence and interactions with councils. Other variants of the stakeholder theory are not applicable to this study due to their incompatibility with the research question. The normative stakeholder theory focuses on moral foundations and principles to guide an organisation, while the instrumental stakeholder theory focuses on the effects of stakeholder management on the achievement of organisational objectives such as financial performance and profitability.

The managerial aspect of the stakeholder theory is used to describe how organisations actually identify their stakeholders (Agle et al., 1999), manage their relationships with multiple stakeholders (Jones, 1995) and incorporate stakeholders’ views in their decisions (Gibson, 2000). This aspect can be used to identify key stakeholders of an organisation and explore how their sustainability concerns are integrated in the accounting and reporting process.

Mitchell et al. (1997) suggest that power, legitimacy and urgency will affect the degree to which stakeholder needs are met, a concept referred to as salience. Power is the ability to influence outcomes of an organisation in a desired manner. A stakeholder is said to be in power when s/he controls the supply of critical resources required by an organisation or holds a principal position to control, reward and disregard the actions of an organisation (Mitchell et al., 1997).

The legitimacy attribute is used to explain that only legitimate stakeholders’ claims will be addressed by an organisation. However, without power the legitimate stakeholders will not always have a serious impact on the decisions and behaviour of the organisation. Legitimate stakeholders could gain power over time and change organisational behaviour (Driscoll and Starik, 2004).

The urgency attribute of stakeholder salience is “the degree to which stakeholder’s claims call for immediate attention” (Mitchell et al., 1997, p. 687) by an organisation in respect of their legitimate demands. Urgency could arise due to time sensitivity or the critical nature of the issue (Mitchell et al., 1997). The existence of one, two or three attributes in a stakeholder contributes to stakeholder salience. Organisations usually pay attention to the matters of those stakeholders who have power in relation to the organisation, are deemed legitimate and have urgency for consideration of claims (Laplume et al., 2008).

Having identified stakeholders, corporations need to determine their salience in order to manage them. The management of stakeholders is dynamic, as their salience will change over time. Mitchell et al. (1997, p. 879) posit:

[...] stakeholders change in salience, requiring different degrees and types of attention depending on their attributed possession of power, legitimacy, and/or urgency, and that levels of these attributes (and thereby salience) can vary from issue to issue and from time to time.
In a further paper, Agle et al. (1999) support the theoretical model of Mitchell et al. (1997) with empirical evidence, stating that the three stakeholder attributes do significantly increase stakeholder salience. The notion of stakeholder salience, therefore, expands the managerial stakeholder theory by highlighting that the attributes of power, legitimacy and urgency will determine the extent to which organisations engage with their stakeholders.

In addition to these attributes, Driscoll and Starik (2004) recognise proximity as an additional attribute that can play an important role in stakeholder recognition and interaction. Proximity is characterised by the existence of space, common ideas, approaches and actions between different groups and individuals, especially when they share the same physical boundary. The authors argue that the greater the proximity, the greater the possibility of the development of stakeholder relationships.

This study uses the managerial stakeholder theory to provide an understanding of the stakeholder engagement in sustainability accounting and reporting process through the application of the concepts of stakeholder salience espoused by Mitchell et al. (1997) and Driscoll and Starik (2004). Stakeholder power, legitimacy, proximity and urgency provide an understanding of the extent to which stakeholders are engaged in sustainability planning, accounting and reporting.

3. Sustainability accounting and reporting and the role of stakeholder engagement

3.1 Sustainability accounting and reporting
Sustainability accounting and reporting is a process of measuring and communicating sustainability performance and of being accountable to internal and external stakeholders for an organisation's social, environmental and economic performance (GRI, 2013). However, “sustainability accounting” and “sustainability reporting” are usually regarded as two distinct and disconnected practices. Generally, sustainability accounting is described as an information management and accounting method that aims at creating and providing high-quality information to demonstrate the progress of an organisation toward its sustainability goals. Sustainability reporting is described as a formalised means of communication to disclose the organisation’s sustainability performance.

In defining and examining both practices, the linkage between the two is generally overlooked. Sustainability accounting and sustainability reporting together form an effective accountability system that captures information about sustainability performance and communicates this information to stakeholders. Reporting the performance depicts the outcomes attained against stakeholders’ expectations and allows organisations to evaluate their sustainability outcomes against sustainability goals. Schaltegger and Wagner (2006) argue that the linkage of sustainability accounting and sustainability reporting is critical for two reasons. First, linking makes the information influential and thereby ensures it contributes to sustainable development. Second, the linkage would avoid superficial reporting of sustainability performance as the only information that will be disclosed is that backed by actual performance.

In order to establish the linkage between strategy, accounting and reporting this paper uses the integrated framework for sustainability accounting and reporting of Schaltegger and Wagner (2006). This framework positions sustainability reporting beyond mere rhetoric and an isolated communication process by linking it to strategic planning and accounting. Moreover, the sustainability accounting and reporting process is recognised as a process of organisational network and learning wherein an organisation engages with its stakeholders in various phases of accounting and reporting. An understanding of the sustainability accounting and reporting process is important in this study for observing the role of stakeholder engagement in each stage of the process.
According to Schaltegger and Wagner (2006), sustainability accounting and reporting commences with the identification of sustainability issues and analysis of their strategic compatibility with sustainability goals. This is followed by linking the sustainability targets with organisational strategy. The linkage of sustainability goals to the organisational strategy is important to align the sustainability outcomes with overall performance outcomes and to ensure the availability of funds to pursue sustainability objectives. After setting sustainability indicators, an accounting system is established to capture data on actual performance to communicate outcomes to stakeholders. Schaltegger and Wagner’s (2006) framework suggests an integrated framework for sustainability performance measurement linking three overlapping groups of approaches: sustainability planning, sustainability accounting and sustainability reporting. However, this efficient system would require external and internal stakeholder input at the planning, accounting and reporting stages, including setting sustainability performance indicators, developing measurement tools, monitoring and measuring the indicators, structuring sustainability reports to reflect stakeholder expectations and refining the reports on a continuous basis (AccountAbility, 1999; Schaltegger, 2012; Brown and Hicks, 2013).

Prior literature indicates that sustainability reporting in PSOs, including local councils, lags behind the private sector (Frost and Seamer, 2002; Dickinson et al., 2005; Sciulli, 2009; Tort, 2010; Williams et al., 2011). There is, however, a need to take a step back and explore the role of stakeholder engagement in sustainability accounting and reporting. This would provide a more comprehensive and in-depth understanding of current practices in the public sector.

3.2 The role of stakeholder engagement in the sustainability accounting and reporting process

While pursuing sustainable development objectives, organisations realise that they cannot act alone to prepare sustainability accounts and reports (Isenmann and Kim, 2006). Organisations require the cooperation of their stakeholders to identify the social and environmental issues as they perceive them. Sustainability accounting and reporting can provide a basis for managing complex stakeholder relations and shifting towards more sustainable operations (Ball, 2002). For example, a research study by Yau (2012) on waste recycling in Hong Kong, where landfill space is becoming scarce, suggested that in order to promote waste recycling behaviour in the community it is necessary to understand what encourages people to act in a particular manner before formulating policies and schemes.

If policies and schemes do not agree with community expectations and needs, all the efforts to promote such initiatives will be ineffective, especially in matters where the direct and active participation of stakeholders is a must for the success of a project (Yau, 2012). This paper argues that stakeholder engagement is an integral component of the sustainability accounting and reporting process (see Figure 1).

In the sustainability planning stage, organisations establish sustainability accounting and reporting commitments. Along with these, organisations can commit themselves to the role of stakeholders and define governance procedures to ensure the involvement of stakeholders in the process. According to AccountAbility (1999), the identification of stakeholders and characterising organisational relationships with each group is the essence of the planning stage. Such thoughtful processes have the potential to embed stakeholder aspirations and concerns into organisational values and missions (Bryson, 2011). The involvement of stakeholders assists organisations to develop and improve strategy as well as to identify and address operational issues (AccountAbility, 2015).

AccountAbility (1999) considers stakeholder engagement as one of the core components of the sustainability accounting process because it can enable an organisation to identify
stakeholder issues regarding its activities and social, environmental and economic performance. It also enables organisations to develop sustainability indicators and such indicators can effectively reflect the organisation’s performance in relation to its values and objectives, the values and aspirations of its stakeholders, and wider societal norms and expectations.

Moreover, stakeholders can be engaged in the process of developing and refining the sustainability accounting tools as well as in collecting information on organisational performance. This involvement offers the additional advantages of drawing on stakeholders’ knowledge to facilitate problem solving, enhancing stakeholder knowledge about the organisation and encouraging them to “buy-in” to the sustainability accounting process (Brown and Hicks, 2013). During the preparation of sustainability reports, stakeholder engagement facilitates organisations to recognise stakeholders’ information demands regarding content, form and media in order to develop a sustainability report that meets their specific needs (Isenmann and Kim, 2006). Stakeholders can be engaged: to articulate their needs and expectations in relation to reporting, obtain feedback on reports to ensure continuous improvements of reports and consult on future efforts on sustainability issues and the coming reporting cycle (Isenmann and Kim, 2006).

3.3 Stakeholder engagement in practice
Current literature has examined the nature and role of stakeholder engagement in the sustainability accounting and reporting process. Belal (2002) examined the sustainability reports of 17 UK companies using AccountAbility as a benchmark to analyse stakeholder engagement practices in the companies. He found that although most of the companies were identifying their stakeholders, they were not promoting the ideal stakeholder accountability. Rather, the companies used stakeholder engagement as a legitimisation tool and for managing stakeholders effectively. The study also indicated a poor quality of stakeholder involvement and an unwillingness to incorporate stakeholder feedback.

Similar findings were made by Lingenfelder and Thomas (2011) in a study of stakeholder inclusiveness in sustainability reporting in 11 South African mining companies. They found
that most of the companies adhered to the minimum quantitative GRI stakeholder engagement requirements, rather than engaging with stakeholders in the development of sustainability reports. The companies lacked extensive dialogue and interaction, specifically for developing sustainability reports. The authors observed that the mining companies adopted a “tick box” approach to sustainability reporting and did not engage in a formal process that could inform and improve such reporting. Moreover, the reporting content failed to address the information needs of stakeholders, as the companies did not seek stakeholders’ aspirations for reporting content and structure.

In order to explore the influence of stakeholder engagement on sustainability reporting, Prado-Lorenzo et al. (2009) examined annual reports of 99 Spanish companies. Their study highlighted that the influence exerted by stakeholders, especially government and creditors together with the strategic posture of an organisation, has an important effect on the publication of sustainability reports. The study also indicated that government is one of the most important drivers for change and can affect sustainability disclosure practices of politically visible organisations.

In line with the above, several studies have also found a limited role of stakeholder engagement in the development and improvement of sustainability reporting (Manetti, 2011; Frost et al., 2012; Imoniana et al., 2012). However, these studies emphasised the importance of stakeholder engagement in planning and accounting.

Manetti (2011), Greco et al. (2013) and Hörisch et al. (2015) indicate that the role of stakeholder engagement is relatively greater in defining sustainability strategic goals, getting feedback on present strategies and deciding resource allocation than in defining the contents of reports. Similarly, Rodrigue et al. (2013) in their study of a large natural resources sector organisation observed significant influence of stakeholders on environmental strategy and performance indicators. Additionally, Imoniana et al. (2012) highlighted the involvement of stakeholders in the budgeting process in Brazilian municipalities. Stakeholders also played a vital role in monitoring sustainability indicators to evaluate the commitments of the municipalities.

In an in-depth study of an Australian local council, Frost et al. (2012) identified a range of stakeholders interested in the council’s sustainability reports. Key stakeholders included residents, businesses, investors, state and federal government agencies, academics and NGOs. Although stakeholders were engaged exclusively in the budgetary process, very little external engagement with them existed in the performance measurement and the development of the sustainability reports.

A recent study by Brown and Hicks (2013) of the Canadian Consumers’ Community Cooperative provided evidence of successful stakeholder engagement in establishing sustainability accounting tools. They found that this engagement not only enhances mutual understanding and encourages relationship building but also contributes to the quality, credibility and relevance of the tool itself.

An overview of prior literature suggests that there is a need to extend the examination of stakeholder engagement from a mere focus on sustainability reporting as undertaken in a number of general studies to include the entire sustainability accounting and reporting process within a specific context. Thus, this study will explore the role of stakeholder engagement in sustainability planning, sustainability accounting and sustainability reporting through an in-depth study of three Australian local councils.

The review of literature here depicts a lack of theoretical grounding for studies into stakeholder engagement. The use of the stakeholder theory is implied, rather than applied within the context of the study. This study uses the managerial stakeholder theory, conceptualised through the stakeholder salience concepts of power, legitimacy, urgency and proximity, to gain an understanding of the role of stakeholder engagement in the sustainability accounting and reporting practices of Australian local councils.
Prior literature highlights a lack of managerial perceptions on effective stakeholder engagement practices. Within the context of the managerial stakeholder theory, this study uses interviews and documents to gain an in depth understanding of the stakeholder engagement practice. The interviews highlight managerial perceptions about the role of stakeholder engagement in the sustainability accounting and reporting process. The documents provide contextual information about each council and their reporting and engagement practices.

Although PSOs, especially local councils, share a close relationship with their local communities, most prior studies have investigated the stakeholder practices of the private sector. There are likely to be differences in the stakeholder engagement practices of the public sector and these can be only established through a study of their practices. This research aims to address this gap by exploring the nature of stakeholder engagement in the context of local councils.

4. Research methods

The case study research strategy (Gomm et al., 2000; Stake, 2003; Simons, 2009; Swanborn, 2010; Yin, 2013) was used for this study. A case study is an empirical investigation undertaken to gain an in-depth understanding of a particular phenomenon (Yin, 2013). It is considered as both a process of inquiry of a case and the outcome of that inquiry (Stake, 2003). Case study was considered an appropriate research strategy for this study because:

- it focuses on the investigation and description of a contemporary phenomenon in depth in its natural context and hence is suitable to explore the role of stakeholder engagement in the sustainability accounting and reporting process;
- it emphasises the process rather than the outcome of an event and hence is useful for this study to explore how stakeholder engagement (process) takes place in the development of strategic plans, sustainability indicators and sustainability reports (outcome); and
- it allows the use of a range of data sources such as documents and interviews to collect and triangulate the data.

As this study aimed at analysing stakeholder engagement in the accounting and reporting process, the identification of local councils that engage with their stakeholders was critical. In order to identify contextually rich local councils, the annual/sustainability/SoE reports of 523 Australian local councils were analysed (see Kaur and Lodhia, 2014). The focus of the analysis was on disclosures of stakeholder engagement made by the local councils in their reports. International standards such as AccountAbility (1999) and GRI (2013) provided criteria for assessment of disclosure of stakeholder engagement in reports and these were utilised for the current study.

We used a scoring system to rank the disclosures of stakeholder engagement with the intention of selecting specific councils for in-depth cases. This analysis located 23 local councils and out of them three councils were found to be disclosing stakeholder engagement initiatives extensively (according to our scoring system) when compared to other councils. However, this analysis was limited to disclosures of stakeholder engagement and it was possible that some councils were undertaking stakeholder engagement extensively but not disclosing their activities in reports. To overcome this, we sought expert advice from the local association that assists councils in the sustainability aspects of their operations. An interview was undertaken with the ICLEI-Oceania’s Integrated Sustainability Services manager to evaluate our findings from the analysis of reports. Her knowledge based on the association’s interactions with the various councils assisted the selection process, confirming the three councils based on the analysis of reports and identifying a further three
leading practice councils. This approach ensured that selection of councils was not merely restricted to those that disclosed their stakeholder engagement practices but also included those that were regarded within the industry to be leading the practice of stakeholder engagement in sustainability accounting and reporting. Thus, six local council organisations were found to be undertaking stakeholder engagement more extensively than their counterparts.

Having identified the case study organisations, all six local councils were approached to gain research access and establish initial contacts. Two of them were going through major organisational restructuring and resource difficulties. The initial talks with their executives indicated that it would not be worthwhile to select these local councils for the research. One local council declined to participate in the research. Therefore, this paper focuses on the analysis of stakeholder engagement practices of three local councils. Two of these were based on our analysis of reports and another was identified in our interview. They will be referred to from this point onwards as Council A, B and C. The study was conducted from 2011-2014.

The first two councils are subject to the requirements of the NSW state government to produce annual SoE reports. Thus, sustainability reporting is mandatory for these councils with Council A being a leader in terms of winning various reporting awards. The two councils are early adopters of the Integrated Planning and Reporting (IP&R) framework of the NSW government. Their extensive reporting over the years suggests that they addressed the sustainability initiatives of the NSW government seriously. On the other hand, Council C was not subject to mandatory reporting but its numerous national and international awards suggest that it took pride in its sustainability reporting. Moreover, the interview with the ICLEI-Oceania’s Integrated Sustainability Services manager and the preliminary documentary analysis revealed that these local councils engaged extensively with their stakeholders, justifying their selection for this study.

The data collection methods included interviews with key personnel involved in the sustainability accounting and reporting process and stakeholder engagement, and using documents related to the three councils’ stakeholder engagement practices. Public documents were the first access point to the local councils and provided an account of their sustainability issues, plans, policies and strategies. Although the majority of the documents were available publicly, some internal documents were also accessed. The focus during the analysis was on collecting evidence on the nature of stakeholder engagement rather than word count and page count for stakeholder engagement disclosures.

Interviews were useful to gain in-depth insights into the local councils’ approaches and philosophies towards stakeholder engagement. This approach is consistent with the engagement research approach advocated by Adams and Larrinaga-González (2007) and Ball et al. (2012).

A total of 22 interviews with the three local councils were conducted in two stages. The first interviews with the local councils aimed at gaining insights into their sustainability accounting and reporting process. The second series of interviews focused specifically on the sustainability accounting and reporting process and the role of stakeholder engagement therein. Table I highlights interviewee’s profiles. The interview data were analysed using manual coding as well as the NVivo software program to ensure that all themes arising from the data had been recognised during the analysis.

5. Findings
5.1 The sustainability accounting and reporting process
The results of the three cases support Schaltegger and Wagner’s (2006) integrated reporting framework for sustainability performance measurement and communication, as discussed in Section 3. In Council A the strategic plan identified local sustainability issues, the delivery programmes outlined action plans to address these issues and a resource strategy allocated
funds to implement the action plans. The accounting system then determined sustainability indicators to measure success or failure of the programmes, followed by reporting on the actual performance. The other two councils used similar pathways to measure and to communicate information about their sustainability performance. However, Council C established a sustainability vision through community consultation before developing strategic and other supporting plans.

The current study’s findings indicate that the development of a resource strategy is an important component of the sustainability accounting and reporting process as it ensures a sufficient allocation of resources – assets, money and staff – to achieve the targets. Figure 2 summarises the sustainability accounting and reporting process across the three councils.

5.2 Stakeholder engagement in sustainability accounting and reporting
Stakeholder engagement was considered as a two-way interaction tool between the councils and their stakeholders. The interviewees acknowledged it as a communication process that

<table>
<thead>
<tr>
<th>Local councils Interviewees Position</th>
<th>Job responsibilities</th>
<th>Interview stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1 Sustainability Coordinator, Environmental Services Group Manager, Leadership</td>
<td>Responsible for corporate sustainability processes, including reporting</td>
<td>1, 2</td>
</tr>
<tr>
<td>A2</td>
<td>Responsible for corporate sustainability processes, including reporting</td>
<td>1, 2</td>
</tr>
<tr>
<td>A3 Senior Environmental Planner</td>
<td>Responsible for incorporating sustainability in corporate processes</td>
<td>2</td>
</tr>
<tr>
<td>A4 Strategic Planning Coordinator</td>
<td>Responsible for incorporating sustainability in corporate processes and community engagement</td>
<td>2</td>
</tr>
<tr>
<td>A5 Senior Corporate Planner, Community and Cultural Department</td>
<td>Responsible for community engagement programmes</td>
<td>2</td>
</tr>
<tr>
<td>B1 Divisional Manager, Environmental Services</td>
<td>Responsible for corporate sustainability processes, including SoE reporting</td>
<td>1, 2</td>
</tr>
<tr>
<td>B2 Divisional Manager, Governance and Integrated Planning</td>
<td>Responsible for incorporating sustainability in corporate processes, IP&amp;R framework and community engagement</td>
<td>1, 2</td>
</tr>
<tr>
<td>B3 Director, Corporate and Technical Services</td>
<td>Responsible for corporate sustainability processes, including reporting</td>
<td>2</td>
</tr>
<tr>
<td>B4 Divisional Manager, Technical Services</td>
<td>Responsible for maintaining physical infrastructure of the council</td>
<td>2</td>
</tr>
<tr>
<td>B5 Senior Environment Officer</td>
<td>Responsible for incorporating environmental sustainability in the council’s plans and programmes</td>
<td>2</td>
</tr>
<tr>
<td>B6 Divisional Manager, Finance and Information Systems and Services</td>
<td>Responsible for financial accounting and managing information systems of the council</td>
<td>2</td>
</tr>
<tr>
<td>C1 Coordinator, Corporate Planning and Performance Project Officer</td>
<td>Responsible for corporate sustainability processes, including reporting</td>
<td>1, 2</td>
</tr>
<tr>
<td>C2 Project Manager: Annual reporting</td>
<td>Responsible for corporate sustainability processes, including reporting</td>
<td>1, 2</td>
</tr>
<tr>
<td>C3 Coordinator, Corporate Performance Management</td>
<td>Responsible for compiling and preparing annual reports</td>
<td>2</td>
</tr>
<tr>
<td>C4 Coordinator, Community Consultation</td>
<td>Responsible for community consultation programmes</td>
<td>2</td>
</tr>
</tbody>
</table>

Table I. Interviewees’ profiles
flows from both directions and is not limited to merely providing information. Interviewee C4 stated that stakeholder engagement involves:

Those opportunities where we interact with our community that might be whether we seek feedback on specific projects, it may be through open forums, open boards, “Have a say day” website that we have. For me community engagement is quite broad that involves two-way communication with the community (sic.).

Stakeholder engagement was regarded in each council as an essential component of the accounting and reporting process which assists in collecting information about the community’s needs and expectations and incorporating them in the council’s sustainability initiatives. For instance, Interviewee B3 stated that:

Stakeholder engagement is the lifeblood for us; it is like the oxygen that supplies the lungs of integrated planning and reporting. Because what happens, now we have to constantly test back with the community as to whether we are achieving their long-term vision. Then under integrated planning and reporting, we have to go back to the community on a regular basis and say is your vision that you provided for us still holding true.

The process of stakeholder identification and prioritisation of stakeholders was regarded as complicated by the interviewees. The reason for this complexity can be associated with the goals and nature of services provided by the local councils as well as their role in promoting sustainable development. The interviewees asserted that the term stakeholder is much broader than it is usually understood because in relation to sustainability, all groups and individuals who are either impacted by local sustainability issues and/or contributing towards sustainability goals are stakeholders. For instance, Interviewee A3 stated that:

I cannot see how anybody is not impacted by sustainability and how anybody cannot influence it somehow. I do not think that sustainability has a key stakeholder kind of a thing. Rather it is so broad that everybody should be a key stakeholder in it. At micro level, both a teacher and his students studying recycling and worm farming are stakeholders and at macro level, suppliers and architects making sustainable choice for materials consumption are stakeholders. It is an all-encompassing thing (sic.).

Stakeholders were identified and engaged using surveys, focus groups, social media, meetings and workshops. The councils had a broad range of stakeholders identified through these mechanisms but were continually wary of the emergence of any new stakeholders. For instance, social media interactions were a useful approach towards ascertaining developments in, and emergence of (new) stakeholders.

The councils responded to the identification of a broad range of stakeholders by prioritising major stakeholder groups and these included local communities, regulators, internal stakeholders, professional bodies and transient stakeholders. Therefore, in line with Andriof et al. (2002, 2003), these councils dealt with major stakeholder groups rather than addressing stakeholders on an individual basis.

Local community was a generic term used by these councils and this was taken to include ratepayers, Indigenous Australians, Cultural and Linguistically Diverse groups, residents and local businesses. They were considered to be one of the most important stakeholders of the councils. Another influential stakeholder group was regulators including
the Division of Local Government (DLG), the state government and the federal government. They had a significant influence on the three local councils' decisions. Their influence prevailed in the form of enforcing regulations such as incorporating quadruple bottom line, a community engagement strategy, a sustainability vision, and the IP&R framework. Furthermore, internal stakeholders, especially the senior management team – general manager, directors and chief executive officer (CEO), and employees, were recognised as one of the major stakeholder groups. Professional bodies were also perceived as an important stakeholder because they offered their expertise for establishing efficient accounting and reporting systems. These included sustainability consultants, local government bodies such as ICLEI-Oceania as well as reporting adjudicators such as those involved in annual reporting awards.

Along with the local community, visitors significantly influenced the local sustainability of Councils B and C. Council B’s area attracted more than two million visitors annually resulting in a huge impact on environmental and economic sustainability. The concerns relating to visitors included local ecology, pressure on streets, parking areas and education for backpackers’ children. The interviewees mentioned that the council regularly attempts to create awareness among visitors about their ecological footprints but they have proved to be the most difficult group to engage with because of their transient nature. Interviewee B4 raised this concern and stated that being a tourist destination means the area attracts:

2 million visitors a year and that is a huge stakeholder group. That’s very transient and hard to sort of communicate with and engage with. A huge population of backpackers that come here for 2 or 3 months, we try to tell them about what to do with their garbage and how to look after the area but we don’t know about the channels of contacting them because you know they are not the landowners.

The primary concern relating to engaging with such transient groups for Councils B and C was finding an appropriate channel of establishing contact. Contrary to the residents, whose residential contacts are readily available, transient groups lack contact points for providing information and obtaining feedback.

Another transient stakeholder group that influenced the planning process and outcomes of the three local councils included councillors and mayors. They significantly impacted the identification of local sustainability issues and funding approvals for the council’s programmes. They were considered as representatives of local voices but occasionally councillors’ opinions dominated the community consensus. However, this stakeholder group was transient because their role was confined to a fixed election term and councillors faced the uncertainty of not being elected for the subsequent term. The interviewees mentioned that due to the transient nature of this group the council has had different councillors with dissimilar visions for the city, including a limited focus on sustainability and community engagement.

It was interesting to note that while the councils identified and prioritised a broad range of stakeholders, their focus was primarily on human stakeholders. Driscoll and Starik (2004) highlight that the concept of proximity enables the physical environment to be perceived as an important stakeholder. In a context such as the public sector, one could expect a greater emphasis on the environment and its recognition as a stakeholder. However, this was not reflected in the three councils’ sustainability accounting and reporting process, possibly due to the difficulties in engaging with non-human stakeholders when compared to human stakeholders.

This study indicates that engagement with a broad range of stakeholders played a vital role in the entire sustainability accounting and reporting process of the councils in this study. It assisted local councils to identify and prioritise sustainability issues, develop strategic plans and sustainability indicators, measure sustainability performance and
ensure continual improvement of sustainability reports. The interviewees identified a range of stakeholders who played multiple roles in the process. For example, the local community played a critical role in the identification of sustainability issues, the development of the strategic plan, and the determination and measurement of the sustainability indicators. Similarly, the state government played an important role in regulating the sustainability accounting and reporting process as well as providing sustainability performance data.

These findings highlight that the public sector context does provide a basis for a far more extensive recognition of stakeholders and a need for engagement with them. However, the fact that a resource strategy ultimately has an impact on sustainability accounting and reporting (and thereby impacting stakeholder engagement) does suggest that economic impediments do have the potential to override the intentions of councils to engage with their stakeholders. An examination of the actual stakeholder engagement practice provides a descriptive account of the extent to which stakeholders play a role in sustainability accounting and reporting.

5.2.1 Stakeholder engagement in sustainability planning. Stakeholder engagement emerged as a key component of the sustainability planning process. Interviews and documents revealed that the three local councils actively engaged with stakeholders to identify and address their key sustainability concerns, to establish the overarching sustainability vision and action statements for a sustainable city, and to develop strategic and other supporting plans.

It was critical that a range of stakeholders whose support was needed by the council were consulted. Interviewee A3 mentioned that critical (salient) stakeholders for sustainability planning are those:

Who have control over decisions that have impact. That is where senior management comes in, they set the tone and the direction for the organisation. And then those people who are impacted by your decisions, such as people paying their rates. They want to know whether or not the money is being wasted.

Legitimacy and proximity were the key attributes that determined the stakeholder salience in the sustainability planning stage. Stakeholders were engaged because they shared the same physical space with the local councils and had legitimate concerns about sustainability planning.

There was an increasing emphasis on the local community as a legitimate stakeholder for sustainability planning, and therefore engagement with them was of absolute importance. The local councils engaged with these communities because they possessed a unique knowledge base and engagement with them enabled the local councils to develop their strategic plans addressing social, environmental, cultural and economic issues. The interviewees also mentioned that the involvement of different local community members in the strategic planning assisted the council to identify and address group-specific issues. For instance, engagement with Aboriginal partners was critical to recognising and preserving the local Aboriginal heritage and culture. Similarly, the involvement of business groups and leaders was important for advancing economic sustainability because they had knowledge and understanding of local economic issues.

The local councils therefore recognised and valued the wealth of skills, knowledge and expertise in their communities and aimed to use these to improve their decision making. Effective stakeholder participation in planning was regarded as a symbol of good democracy, good business and good management (Council A’s Strategic Plan).

The three local councils shared spatial nearness with their local communities. The local councils and their local communities also worked together to develop the strategic plans and sustainability vision because they shared common interests, which was to promote sustainable development in the local area. Council A’s Community Engagement Strategy
stated that “there are communities of interest, where people share a particular experience, interest, or characteristic”. Interviewee B2 emphasised the importance of identifying the similar areas of interest or objectives between different parties as this created a sense of mutual stake in them. For example, the notion of sustainable development is a common objective and needs contributions from different players depending upon their role and responsibilities.

Visitors were perceived as a critical stakeholder for Councils B and C but there were no specific approaches used to engage with them. They were considered to be part of, and engaged in a similar way to, the local community, despite their transient nature providing unique attributes to their characteristics as a stakeholder.

The interviewees regarded the involvement of the local community in the planning process as a proactive form of engagement. The aim of this involvement was to create awareness of the importance of sustainability among community members and identify their key concerns. The interviewees were of the opinion that creating awareness about the importance of long-term sustainability benefits was required to divert stakeholders’ thinking from daily activities such as their work, family and mortgage to wider sustainability goals. Interviewee C2 stated:

Considering what impacts somebody can have in the backyard or in the space they are living. We are definitely trying to get the awareness and get people involved in wanting to participate in something that’s really a long-term goal [...] you know every individual just can make a tiny little piece of difference [...] trying to even get them engaged and interested in making a difference will be challenging too (sic.).

The three local councils organised community meetings, open days and used social media to spread the awareness among community members.

Stakeholder engagement assisted the councils to gain insights into stakeholders’ aspirations beforehand “rather than managing spot fires that happen in local government when a development might go across the road and then everyone hates it” (Interviewee B2). Interviewee B5 also emphasised the importance of community engagement during the drafting of a new policy or implementing a new programme:

Community engagement has a potential to gain insights for issues in regard to the council’s draft coastal risk management policy, especially it enables us to gain insights on situations and issues that we may have not thought of. It also enables us to measure the potential success and acceptance of the policy. Implementing a policy that is not supported by anyone is not in the interest of most organisations. It is very beneficial to have feedback to get support or otherwise on policy (sic.).

Interviewee A4 highlighted the importance of engaging with the local community in the development of the strategic plan:

The strategic planning is all about knowing what the community wants. Communities are much more active now and they will tell us. It is interesting to know how people now know more and are interested in climate change, energy saving and waste management and all of those things. Strategic planning it is a process of looking from the inside what is needed but also to take-on board the communities’ views and marrying those up really. I have been doing the analysis on the online feedback – it is amazing the themes that come through and similar to internal ones. It informs us on what is needed. It is a democratic participation and citizenship, about actively being able to contribute to your community (sic.).

The three councils undertook extensive engagement programmes to understand and address stakeholders’ needs and concerns. Council A conducted an engagement programme to identify the current concerns and needs of the local community (Council A’s Community Research Report 2012). This engagement assisted the council to recognise any shift in the local community’s priorities since the development of the strategic plan and thereby revise
the plan accordingly. Similarly, Council B undertook two comprehensive engagement activities in subsequent years to understand its stakeholders’ perspectives about the council’s strategic plan and resourcing strategy respectively. Moreover, the council indicated urgency among stakeholders to implement the outcomes of engagement:

Now that people have taken the leap of supporting a rate rise, their trust in the council will proportionally plummet if the strategic plan is not delivered. Expectations that it should be delivered immediately, rather than over 12 years, may become an issue and ongoing dialogue with the community about priorities will be critical to managing unrealistic expectations (Council B’s Resource Strategy Report 2010).

Council C also undertook two major engagement programmes over a period of time to assess critical views and opinions of the local community regarding the strategic plan and directions.

The findings on stakeholder engagement in sustainability planning provide a descriptive analysis of how stakeholders are engaged in the sustainability planning process. It was evident from the interviews that engaging external stakeholders in close proximity (in relation to spatial awareness and concerns and ideas regarding sustainability), namely the local community, in sustainability planning provided benefits to councils in proactively managing their sustainability impacts and in turn, gaining the support of their stakeholders. Thus, the proactive management of proximate stakeholders was strategic, enabling the councils to engage with legitimate stakeholders at the earliest stage of the sustainability accounting and reporting process.

There was also some emphasis on power and urgency in the sustainability planning stage. Powerful stakeholders such as senior management initially set the agenda for engagement of legitimate stakeholders. There was support from the councillors for this engagement. Similarly, there was urgency by the local community in the expectation that strategic plans were delivered with a reasonable time period, as highlighted by some interviewees. This impacted the strategic plans that stakeholders were asked to provide feedback on, ensuring that these were issues that could be addressed within a reasonable time period.

5.2.2 Stakeholder engagement in sustainability accounting. The interviewees strongly emphasised the importance of stakeholder engagement in setting the sustainability indicators, developing the accounting tools and assimilating the sustainability performance data. This continuum of engagement was considered critical to establish a stakeholder commitment throughout the accounting process. First, engaging with stakeholders in the development of sustainability indicators enabled the local councils to embed stakeholders’ material issues and aspirations in the performance management system. This engagement also provided the councils with an opportunity to explain their expectations regarding the collection of performance data. Second, consulting stakeholders in setting the data collection methods assisted the councils to establish stakeholder ownership over different sustainability indicators, to create a willingness to monitor them and to bind them to measure sustainability outcomes. Third, the involvement of stakeholders was regarded as critical to ensure the supply of sustainability information for evaluating sustainability performance and preparing annual reports. The interviewees mentioned that failure to engage with stakeholders in any of these three activities could result in an ineffective accounting system.

Council A and Council B undertook extensive engagement with their local communities in the development and materiality review of their sustainability indicators suite. Thus, proximity and legitimacy of the local community were key issues for them in relation to the development of suitability indicators.

Council A considered the setting of sustainability indicators as an information sharing process between the council and its stakeholders. Interviewee A1 stated that the development of sustainability indicators “is more of an information sharing process to bring
those things out there for discussion”. Council A developed its first set of sustainability indicators, consisting of 79 sustainability indicators (Council A’ Annual Report, 2007-2008). The interviewees mentioned that key stakeholders who contributed to the development of the suite included council staff and ICLEI-Oceania. Subsequently, it engaged extensively with a range of communities in undertaking a materiality review of the indicator suite. The review aimed at making sure that the council’s “reporting is focused on those issues that are of the greatest concern to [its] communities, [its] organisation and other key stakeholders” (Council A’s Community Strategic Plan). An extensive engagement with the community using telephone interviews and surveys assisted the council to identify ten high priority material issues and to revise the indicator suite. Interviewee A1 stated that “as a part of the materiality review, we have been able to identify 47 indicators as our key indicators, addressing those issues of greatest concern to our stakeholders”. Thus, the stake of the local community was critical in revising the sustainability indicators, with the stakeholder engagement process ensuring that this aspect of sustainability accounting of Council A was reflective of community perceptions.

Council B also conducted a survey to comprehend the community’s perceptions about the city’s sustainability. In all, 90 per cent of Council B’s residents supported the city’s vision resulting in the adoption of the sustainability suite. The SoE report 2009-2010 stated that:

In partnership with the local community, Council has developed 31 sustainability indicators that best represent how the community wants progress toward environmental sustainability measured. By comparing progress in these key areas from year to year, we can monitor Council’s movement toward achieving corporate sustainability goals.

Conversely, in Council C, internal stakeholders such as divisional managers and the CEO dominated the process of setting sustainability indicators. The council initiated a sustainability project to determine a new suite of sustainability indicators for the city and the council. This project required input from internal and external stakeholders. In response, various directors and staff members involved in community services, social planning and cultural space, planning, environment and transport, engineering services and economic development were consulted. Interview data indicate that the selection of indicators started as an internal process involving corporate sustainability planning personnel with a plan to consult the community to gain their opinions and perceptions about the city’s sustainability.

The interviewees mentioned that Council C was using an independent consultancy firm to develop a new sustainability indicator suite. The use of a consultant would enable the council to benefit from skills and knowledge that were beyond its expertise and would ensure a robust stakeholder engagement process for determining the new sustainability indicators. The importance of using the consultancy firm was highlighted throughout the interviews. The interviewees revealed that the council intended to engage with external stakeholders, especially the local community to gain their perspective on a new suite of indicators. However, this plan failed to materialise due to changes in the political set-up in the area. The change in leadership of the council (mayors and councillors) led to an internal focus for the development of sustainability indicators and resource constraints on engagement with the local community. Thus, powerful stakeholders such as mayors and councillors can adversely influence the stakeholder engagement approach of a council.

In relation to the setting of sustainability indicators, it appeared that the initial emphasis was on the “powerful” stakeholders, usually the council staff in the three councils and including ICLEI-Oceania in Council A and a sustainability consultant in Council C. Council staff were regarded as the key stakeholder group for developing the first sustainability indicator suite because the councils considered their employees as an important link
between themselves and the outside world. Being a part of the local community, employees
were perceived to be aware of sustainability issues in the area and thus were considered as
representatives of local voices. For instance, Interviewee A2 stated that:

More than 65% of our employees live in the city. So we almost have our own sort of local resident
base that we can consult with. Then beyond that more than 90% of our staff and employees live
within the region.

Interviewee A3 mentioned that the council staff were a key stakeholder group because
they create awareness in the community about sustainable living. She stated that it is
"us, leading by example and providing the communities with the opportunity in terms of
information when they build a house as to how to make it more sustainable". Similarly,
Interviewee B2 stated:

There's no point of having the money and the assets in place if you haven't got the staff to actually
do the job in the first place. So it requires all the three [delivery program, resource strategy and
workforce management plan] to work together to achieve the outcomes for the community.

Moreover, this group possessed a high degree of influence over decisions that impacted on
the well-being of the local community and the environment. The interviewees mentioned
that in case of a disagreement on issues among community members, the staff reserved the
right to take a decision considering the general interest of the community members and
the council's resources.

There was also the prioritisation of issues, with emphasis on critical indicators and
measures that needed to be dealt with in a reasonable time period. Thus, just like the
development of strategic plans, the engagement of stakeholders in relation to measures and
indicators was impacted by the urgency attribute. Following this, two of the councils
considered other legitimate stakeholders and this led to a similar approach to that used in
sustainability planning; engagement with the community in close proximity. However, for
the other aspects of the sustainability accounting process, it was observed that stakeholder
power and urgency were paramount, with internal stakeholders and external agencies being
prominent. These issues are discussed next.

Council staff imparted significant influence on the measurement of sustainability
performance. Interviewee B6 stated that "with our community strategic plan and with our
targets and indicators, one of the sources of information for us is actually a council staff
survey which we run on an annual basis". The various council divisions monitored and
collected information on sustainability indicators, and supplied the performance data to the
governance manager.

However, the interviewees also raised concerns over differences in opinions among
council staff members, especially between the middle level management and the higher level
management. For instance, Council C's strategic managers appeared to be apprehensive
about their CEO's unreasonable expectations for the sustainability suite due to the
uniqueness of the local sustainability issues and the existence of diverse sustainability
matters, especially at the international level. Interviewee C3 stated:

We can benchmark state and internationally but the international one is the really difficult one
because everyone is just that little bit different. I can get 10 or 12 benchmarks. What that is actually
going to mean to me is absolutely nothing, but it will make the CEO happy. You can always
compare and contrast but I do not see the point in comparing, say, our percentage of native
vegetation cover with the likes of London.

Whilst the collection and assimilation of sustainability data by the three councils was highly
dominated by internal stakeholders, it required input from several external sources, such as
state and federal governments, to evaluate the overall sustainability of the city and the council.
Interviewee C2 for instance stated that the council’s ability to measure sustainability performance is affected by external agencies, including:

State government bodies, their input is going to depend on their budget. Some of the indicators that are a recommended measure are very much dependent upon state agencies continuing to report at the level they are reporting, on the frequency they are reporting and that’s dependent upon their budget. So there is whole trickle-down effect. So this thing looks great, we are going to report on that – wonderful! Next year they pull the budget on that and they don’t report on it any more – back to square one. So, that point of view, that sort of stakeholder engagement, can have consequences on the future of the reporting.

The regulatory bodies were considered as a powerful stakeholder for sustainability performance measurement. Interviewee A1 stated that they were “influencing us in our plans and also making sure that we are aligned with other stakeholders’ needs”. They provided information on different aspects of sustainability and it was essential that this information was provided on a timely basis (urgency). For example, they provided data on physical indicators such as crime, transport, housing affordability, unemployment and community demographic data.

In summary, the sustainability performance measurement process required input from internal and external stakeholders on a timely basis. Internal stakeholders used the sustainability performance data through in-house database systems. External stakeholders, namely regulatory authorities, supplied sustainability data captured through their own accounting systems and provided perception-based data to measure qualitative indicators.

The findings related to the role of stakeholder engagement in sustainability accounting are in line with managerial stakeholder theorising. There was a greater involvement of internal stakeholders in this stage of the sustainability accounting and reporting process, even though there were some differences in the perceptions of middle and top management. However, the local community were consulted in order to get consensus on measurement of sustainability performance. Stakeholder power and urgency were the dominant attributes that explained the salience of stakeholder engagement in this stage of the sustainability accounting and reporting process. It appeared that once feedback was gained through engagement with proximate and legitimate stakeholders (local communities) in the development of sustainability plans and indicators, stakeholder power and urgency took precedence in accounting for and assimilating the sustainability performance data. “Powerful” internal stakeholders and regulators were involved in determining sustainability performance measurement approaches with the urgency attribute also guiding their decision making process. In the case of Council C, the effect of transient stakeholders such as the mayor and councillors led to minimal involvement of local communities in the entire sustainability accounting process.

5.2.3 Stakeholder engagement in sustainability reporting. The annual reports of the three local councils targeted a range of stakeholders, including local communities, visitors (for councils B and C), regulators, professional bodies and internal stakeholders. As discussed earlier, visitors were perceived as part of the local community. In a similar manner to the sustainability planning, the engagement for sustainability reporting had the support of councillors and the mayor but they were not engaged specifically due to their perceived lack of interest.

In terms of the development of sustainability reports, internal stakeholders such as council staff and senior management exerted a significant influence on the reporting contents and structure. In Council A, the involvement of the council staff in preparing the annual reports highlighted the usefulness of stakeholder engagement in enhancing the reports. The interviewees mentioned that the council undertook an employee engagement programme to understand users’ needs for sustainability information.
This engagement provided an opportunity for the council staff to express their views about reporting style and contents. Consequently, when the report was released, it was well received among the staff.

Similarly, in Council B, the council staff have mainly contributed to the development and improvement of the reports. A minimal external stakeholder (community) input was observed in the reporting stage in comparison to the sustainability accounting and planning stages. The preparation of the annual reports was regarded as more “formal documentation processes” where the reports were a summary of the outcomes of annual activities.

In contrast, the annual reports of Council C were highly stakeholder centric. The interviewees mentioned that the council regularly engages with internal stakeholders and the external community to share stories about the council’s sustainability performance. This active engagement enabled the council to improve the receptivity of reports. For instance, the most recent report included views and snapshots of key council staff who contributed to the overall sustainability of the council and city. Moreover, Interviewee C3 passionately recalled the photography by the council which turned a technical process into an interactive and “funky cool” activity:

We had a photo shoot over the council’s chambers, where I photographed the mayor, and the CEO and the Chief Financial Officer and all these guys [community members]. We did the photo shoot and we filmed that and it was like turning the annual reporting from our document like this to more like a funky cool sort of thing, a happy thing to do because they all came in, got faces painted, took all cool photos. These people haven’t actually got many acknowledgements for some of their work previously and this engagement gave them a feeling that council really appreciate them for what they are doing as well (sic.).

These findings in relation to the development of sustainability reports highlight a difference in the stakeholder engagement approach in the councils. For Councils A and B, stakeholder power in the form of internal stakeholders took precedence with the expectation that legitimate stakeholders such as the communities in close proximity were engaged in the development of sustainability plans and indicators. However, for Council C, engagement with legitimate stakeholders such as the local community was crucial at the development of sustainability reports stage, leading to the increasing involvement of proximate stakeholders. Given that the Council C did not involve the community in the development of its sustainability indicators as discussed in the preceding section, this led to an increasing need to engage with legitimate stakeholders in the development of reports.

The refining and improving of reports was guided by the need to engage with legitimate internal and external stakeholders in close proximity (the local communities) as well as regulators and professional bodies. Councils A and C recognised the importance of stakeholder engagement to ensure continuous improvement of the reports and, therefore, actively engaged with different stakeholder groups. Council B on the other hand was limited in its engagement with a range of different stakeholders. These issues are discussed next.

In terms of refining and improving the reports, Council A and Council C regularly engaged with internal stakeholders as well as the local community, regulators and professional bodies to ensure continuous improvement of the annual reports. On the other hand, Council B’s stakeholder engagement was limited to obtaining feedback on the content and structure of annual reports through public exhibitions targeting the local community.

Councils A and C used two distinct channels – professional advice and general stakeholder review – to gain feedback on their annual report. The interviewees mentioned that the majority of the feedback on the reports had come from internal processes and reporting adjudicators. The two councils actively sought feedback from ARA adjudicators.
by submitting their annual reports for expert panel review. The feedback received from this process significantly improved the quality of reporting. Interviewee A1 stated that:

The council sends its annual report to Australasian Reporting Awards and use feedback from the judging process to really refine how we are reporting. The feedback has been also quite useful to make sure that we are leading towards best practice in sustainability reporting. So the feedback has been a very useful way to improve our report, you can definitely see that each year it [reporting] has changed due to it.

Moreover, Council A also had an option to consult with the DLG about the quality of its annual report. However, the DLG did not prove as beneficial as the ARA Limited because of its passiveness towards the review process. Interviewee A3 mentioned that:

The DLG was meant to be providing us with constructive feedback on last year’s annual report because it was the first one that we had to prepare a report under the integrated reporting and planning legislation, but they told us on Friday that they have not even started looking at it yet. So we need to start preparing this year’s report pretty much now. So I don’t know that we’ll actually get their feedback in time to be able to do that much with it.

The interviewees from Council B mentioned that a lack of feedback from local communities during the public exhibitions meant the council has little understanding of their reporting needs. They highlighted the lack of interest from local communities in reading the annual reports, especially financial statements. Interviewee B6 disappointingly stated that:

It takes a couple of months of good solid work to prepare them. The only downside, I actually can think of is if anyone ever reads them because they’re just a set of financial statements that people [local community members] don’t really understand. The financial people understand them, but I don’t know if there really is an audience for them. So that’s – but still, we still have to produce them. It would be better if someone actually read them.

Similar non-participation was noticed in the general stakeholder reviews for the other councils. The councils demonstrated a keen interest in seeking feedback from the community through telephone interviews and a feedback form attached to the annual reports. The interviewees mentioned that the councils have tried various media such as questionnaires, and telephone interviews to obtain stakeholders’ feedback on the reporting style, format and content, and the relevance and adequateness of the sustainability issues. However, despite their efforts the number of responses has been minimal, contributing negligibly towards refining these reports. Interviewee C4 mentioned:

Unfortunately nobody ever fills them [survey forms] out. We have tried it over the years in a number of different ways. We have tried ones that sort of fold out and drop off and other ones that fall out and other ones that are stuck in and we rarely get more than about 3 or 4 back each year.

Interview data highlighted two distinct perceptions about the lack of feedback from the local community. Some interviewees mentioned that the council received minimal feedback because the community lacked interest in annual reports. Interviewee B6 stated that:

Well their [the community] lives are not going to get better if the report is relevant to them. We work with them [community] to make sure that the [sustainability] indicators are relevant to what they really want to achieve, and then we report on that.

Other interviewees reported that a general level of satisfaction about the contents and structure limits the critical evaluation of reports by the community. Interviewee C4 stated:

I think most people are quite happy with the report. I think it’s one of those things – people tend to only complain or say something when there’s something wrong. Generally if there is something right then they tend not to say anything. So it could be interpreted as the fact that we do a fairly good job and so everyone is reasonably happy so they don’t see a need to say anything about it.
To sum up, in line with the managerial stakeholder theory, internal and external stakeholders were engaged in the sustainability reporting process, guided by the stakeholder salience attributes of power, proximity and legitimacy but there were clearly differences in their extent of involvement across the three councils. It appeared that there was greater benefit in engaging with specific stakeholders such as internal stakeholders and professional bodies (reporting adjudicators). Given that sustainability reporting is periodic and regular, the urgency attribute was not critical for this stage of the sustainability accounting and reporting process.

Engagement with proximate stakeholders such as the local community prior to the actual sustainability reporting was not beneficial for Councils A and B. However, Council C did perceive benefits from engaging extensively with the community in the development of sustainability reports. Once sustainability reports were developed, the practice of engaging stakeholders in sustainability reporting was not recognised across all the stakeholders. Even though councils sought to engage with legitimate stakeholders such as the local community for improving their sustainability reporting, they received minimal feedback. There was greater value in engaging with specific stakeholders such as reporting adjudicators.

6. Discussion
The majority of the research on sustainability accounting and reporting has examined planning, accounting and reporting as three independent organisational practices (Schaltegger, 2012). The current study’s findings suggest that a link between strategic planning, accounting and reporting, and that the involvement of stakeholders is essential to establish an efficient stakeholder-centric accountability system.

Although there were subtle differences in the cross-case analysis, strategic planning was regarded as a prerequisite to the sustainability accounting and reporting process. In the three councils, the strategic plan identified local sustainability issues, the delivery programmes outlined action plans to address these issues and a resource strategy allocated funds to implement the action plans. The accounting system then determined sustainability indicators to measure success or failure of the programmes, followed by reporting on the actual performance. The current study’s findings indicate that the development of a resource strategy is an important component of the sustainability accounting and reporting process as it ensures a sufficient allocation of resources – assets, cash and staff – to achieve the targets. This could, however, impede the good intentions of councils to engage extensively with their stakeholders.

The findings from the three cases explored through Schaltegger and Wagner’s (2006) integrated reporting framework for sustainability performance measurement and communication support the managerial stakeholder theory. The sustainability vision of the councils was embedded into their actual practices. The interviews and documents highlighted that this association enabled the councils to not only measure and communicate actual sustainability performance but also to address the sustainability issues and concerns of stakeholders. Managerial stakeholder theory conceptualised through the stakeholder salience notions of power, legitimacy, urgency and proximity provided a detailed account of stakeholder engagement in all three stages of sustainability accounting and reporting process with the local community being more prominent in the planning and internal stakeholders, regulators and professional bodies being more prominent in the accounting and reporting phases.

In essence, our case studies suggest that involvement of stakeholders earlier in the sustainability accounting and reporting process has greater value so that ultimately, sustainability reports are the outcome of extensive stakeholder involvement. In this study,
the local councils and local communities collaborated to develop strategic vision, strategic plans and sustainability indicators because they recognised the critical importance of sustainability issues in overall development of their local areas. Engaging stakeholders, especially those in close proximity merely in the sustainability reporting process may not be beneficial to councils seeking to enhance their sustainability performance and to be cognisant of the evolving needs of their stakeholders.

In the sustainability planning phase, the needs of legitimate stakeholders in close proximity was paramount and led to extensive engagement with the local communities. They shared spatial nearness and ideas with the local councils and therefore, their concerns were considered legitimate. The sustainability accounting phase focused on powerful stakeholders and on urgent issues. The setting of sustainability indicators in two of the councils initially focused on “powerful” internal stakeholders and professional bodies and the urgency attribute, followed by engagement with the proximate local community who were considered legitimate. However, the other aspects of sustainability accounting (performance measurement) focused on engagement with “powerful” stakeholders such as senior management and on the urgency of the issue.

The sustainability reporting phase saw varying level of engagement with stakeholders. The development of sustainability reports focussed on the powerful stakeholders in two of the councils. Council C on the other hand, which focused on “powerful” stakeholders in the sustainability accounting phase, diverted to stakeholder centric inclusivity and engaged with proximate and legitimate stakeholders, the local community. The refining and improving of sustainability reports focused on a range of legitimate and proximate stakeholders but led to limited feedback from these stakeholders. Sustainability reporting was therefore critical to only internal stakeholders, professional bodies and regulators as they used it as a tool to demonstrate the councils’ progress towards sustainability goals. The periodicity of sustainability reporting led to no influences from the urgency attribute of stakeholder salience. Figure 3 summarises the sustainability accounting and reporting process and the role of stakeholder engagement across the three councils.

It is also worth exploring the stakeholder groups that were not engaged effectively by the councils. While the physical environment is not considered a stakeholder due to the

![Figure 3. Stakeholder engagement and salience in sustainability accounting and reporting](image-url)
inability to engage with this non-human stakeholder, difficulties in engaging with transient stakeholders were paramount. Transient stakeholders such as visitors were regarded as part of the local community, even though their stake is clearly very different from those classified as the generic local community. Visitors had a significant impact on the environmental and economic sustainability of the local area. They were the most difficult group to engage with due to insufficient information on their residential contact. A specific and proactive approach where such visitors were targeted and their inputs sought would have provided a more comprehensive approach to stakeholder engagement to Councils B and C, resulting in the views of all salient stakeholders in the sustainability planning process.

Similarly, transient stakeholders such as the mayor and councillors primarily supported the engagement activities of the councils but were not actively involved in the engagement processes. A lack of interest in these activities by these stakeholders was identified by the interviewees. However, the transient characteristic of such stakeholders suggests that they have the power to change existing engagement processes. As councillors and mayors hold office for a fixed term, subsequent leaders can set different priorities resulting in delays or even the cessation of existing plans and programmes. This was observed in the case of Council C in its engagement with stakeholders for the development of sustainability indicators. The council had to respond to the lack of engagement with the local community in the accounting phase through the involvement of these stakeholders in the development of sustainability reports. However, the feedback from communities in the reporting phase was limited. Therefore, a more extensive engagement of transient stakeholders such as mayors and councillors in the various aspects of sustainability accounting and reporting would ensure their buy-in in the stakeholder engagement and sustainability accounting and reporting process of councils.

In addition to the impact of transient stakeholders (visitors for Councils B and C, mayor and councillors for Council C), the other difference across the councils was in the sustainability reporting phase where Council B relied on engagement through public exhibitions which provided minimal stakeholder feedback. The council could have improved the quality of its sustainability reports through engagement with professional and regulatory bodies in a similar manner to Councils A and C. This highlights the importance and higher degree salience of such stakeholders in the sustainability reporting process of councils, suggesting that a lack of engagement with them could result in lost opportunities for councils in their continuing quest for enhanced sustainability accounting and reporting processes.

ACCA (2005) indicated that the involvement of stakeholders in organisational activities and more precisely in the sustainability accounting and reporting process has become critical on the agenda of both the corporate and public sectors. Our paper provides evidence of stakeholder involvement and suggests that meaningful stakeholder engagement across all the stages of sustainability accounting and reporting can enhance this process. A broad range of stakeholders influenced the councils’ decisions relating to strategic planning, setting sustainability indicators, sustainability performance measurement and the development of sustainability reports. However, the role and influence of each stakeholder varied with their salience explaining the extent of involvement in each stage. For instance, the local community was highly influential in the planning stage but played a limited role in some of the aspects of sustainability accounting. Therefore, local councils should identify and prioritise stakeholders on the basis of their influence and contribution before engaging them in the sustainability accounting and reporting process.

In line with Manetti (2011), Greco et al. (2013), Rodrigue et al. (2013) and Hörisch et al. (2015), the findings of this study indicate that stakeholder input is the core ingredient of the sustainability planning stage. All of the three local councils engaged extensively with their
legitimate stakeholders, especially those in close proximity such as local communities to identify and address sustainability issues proactively rather than in a reactive manner. Such engagement enabled the local councils to gain support of stakeholders about the council’s plans and policies before their implementation to avoid future rejection and disapproval. Moreover, engagement at this stage was considered crucial to create awareness about local sustainability issues among community members. Although internal stakeholders including council staff and councillors initiated the planning process, local communities had direct influence on sustainability plans, strategies and vision of local councils.

Brown and Hicks (2013) emphasised the importance of stakeholder involvement in setting sustainability accounting tools. This study also supports their findings as the local councils required input of both internal and external stakeholders in the accounting process. The development of sustainability indicators was again initiated by council staff in consultation with experts and consultants. But before finalising the indicator suites, two of the local councils consulted their local communities to prioritise sustainability indicators. In line with Frost et al. (2012), the collection and assimilation of sustainability data for performance measurement was highly dominated by internal, "powerful" stakeholders. The findings of this study suggest that the commitment of internal stakeholders can transform stakeholder engagement from a symbolic, legitimising and reputation management process (Archel et al., 2011; Barone et al., 2013) to a democratic dialogue mechanism (Rinaldi et al., 2014). However, local councils needed the support of government agencies to assess social and environmental sustainability in the area. Such reliance emphasises the need for adequate and reliable external networks to capture overall sustainability progress of local areas. These findings are consistent with the views of Prado-Lorenzo et al. (2009) in relation to the importance of governmental stakeholders.

International accountability standards such as AccountAbility (1999) and GRI (2013) emphasise the importance of stakeholder engagement in the sustainability accounting and reporting process, especially in the development of sustainability reports. However, the role of stakeholder engagement has been questioned in the extant literature. For instance, Lingenfelder and Thomas (2011) and Frost et al. (2012) found that very little engagement exists in the development of sustainability reports. In contrast, in a different context, the current study’s findings provide evidence of some level stakeholder engagement in the reporting stage. The findings indicate that the contribution of local communities is relatively greater in the planning and accounting processes than in the reporting processes. Nevertheless, the involvement of professional bodies did influence the development of these reports. Our paper suggests that meaningful stakeholder engagement has potential to address local sustainability issues of stakeholders by embedding them in core strategic planning and performance indicators. Eventually, the reporting process can capture and communicate sustainability performance to key stakeholders.

Prior studies have highlighted that sustainability reporting in PSOs, including local councils, lags behind the private sector (Frost and Seamer, 2002; Dickinson et al., 2005; Tort, 2010; Williams et al., 2011). However, this study illustrates the meaningful role played by stakeholders in the sustainability accounting and reporting process of councils. Our study’s findings are limited to best practice councils, indicating the usefulness of an in-depth exploration of contextually rich councils. It would be of interest to develop an understanding of stakeholder engagement practices in other councils, thereby expanding the explanatory potential of the current study.

The findings of this study provide a positive view of stakeholder engagement in sustainability accounting and reporting. However, the limitations of stakeholder engagement as discussed earlier in this paper cannot be ignored and should be considered when evaluating the effectiveness of stakeholder engagement exercises. As highlighted in this study, stakeholder engagement is controlled by “powerful” stakeholders who have the capacity to
influence any actions taken in relation to sustainability matters. It was observed in this study that transient stakeholders such as the mayor and councils can impact the extent of engagement. Moreover, top management had different views from middle management in relation to some aspects of sustainability performance. Power differentials in stakeholder engagement could therefore impede stakeholder democracy. The views of other stakeholders therefore provide useful insights into stakeholder engagement activities and would provide a complete “picture” of stakeholder engagement in sustainability accounting and reporting. Consistent with prior research, the focus of this research was on an organisational perspective. It did not seek views directly from external stakeholders because this was recognised as being beyond the scope of this paper. However, future research could explore this issue and expand our understanding of stakeholder engagement in sustainability accounting and reporting.

7. Conclusion

This study has highlighted that stakeholder engagement plays a critical role in the sustainability accounting and reporting process. The qualitative research generalisations (Parker and Northcott, 2016) that arose from a study of specific local councils in Australia indicate that a range of stakeholders influence decisions concerning the development of strategic plans and sustainability indicators, and the measurement and communication of sustainability performance.

This paper makes both theoretical and naturalistic generalisations (Parker and Northcott, 2016). In relation to its theoretical generalisations, the paper has integrated two streams of existing literature to address its central research question: the sustainability accounting and reporting process as posited by Schaltegger and Wagner (2006), and the managerial stakeholder theory. Our theorisation has focussed on conceptualisation and context-dependent theorising with the emphasis on the public sector generally and local councils specifically (Llewelyn, 2003).

This study used the integrated accounting and reporting framework as suggested by Schaltegger and Wagner (2006) to assess the role of stakeholder engagement in the sustainability accounting and reporting process. As discussed in Section 3.2, the link between planning, accounting and reporting could enable organisations to measure and to communicate their sustainability performance against stakeholders’ aspirations (Schaltegger and Wagner, 2006). This framework is of use as it highlights a need to consider sustainability planning, accounting and reporting as a continuous process and suggests that stakeholder engagement in each of these stages is of critical importance. Managerial stakeholder theory on the other hand emphasises the notion of stakeholder salience and explains how the attributes of power, legitimacy, proximity and urgency impact the extent of involvement of stakeholders in each stage of the sustainability accounting and reporting process.

The findings of this study add to the limited literature on stakeholder engagement and provide information about various stakeholders and their contributions in the sustainability accounting and reporting process. Our study also highlights the current stakeholder engagement practice in Australian local councils and extends the limited literature on sustainability accounting and reporting in PSOs.

Naturalistic generalisations (Parker and Northcott, 2016) are the specific findings in a research context that have implications for practice and policy. The findings of this research are based on the evaluation of sustainability accounting and reporting practices of the three best practice local councils and suggest that the integrated accounting and reporting framework has the potential to embed sustainability in the core goals of an organisation and to ensure their achievement through a resourcing strategy. Our study provides exemplars of useful practices. Organisations seeking to advance the notion of sustainable development could benefit from linking their accounting and reporting
structures to strategic planning and incorporating stakeholder input in the entire planning, accounting and reporting stages. Moreover, maintaining close relationships with stakeholders in close proximity such as local communities, through their engagement in the earliest stages of the sustainability accounting and reporting process, rather than after the preparation of sustainability reports, is essential. The engagement with regulators in relation to sustainability performance data gathering and the involvement of professional bodies such as reporting adjudicators to improve sustainability reports are other useful practices that could be applied to other settings. Moreover, the critical importance given to the role of internal stakeholders such as council staff in engaging with stakeholders ensures that staff work towards ensuring sustainability goals of the council are met. There are also limitations to the existing stakeholder engagement process in these councils that have implications for other councils; more specifically in relation to the lack of engagement with specific stakeholders such as transient stakeholders and the impact of “powerful” stakeholders such as councillors and senior management on stakeholder engagement.

The findings of this study, while restricted to best practice local councils in Australia have implications for other contexts. These include other public sector entities in Australia and globally. Corporations could also benefit from utilising stakeholder engagement in the various stages of their sustainability accounting and reporting practice and strive to be more transparent in their interactions with stakeholders in regard to sustainability issues.

An understanding of the present practice of stakeholder engagement in the Australian councils is beneficial to stakeholders. They can gain insights into the different decisions and activities requiring their contribution and can understand the various mechanisms available to interact with their council. Certain stakeholders such as NGOs and state and federal PSOs could also apply the understanding gained from this study for establishing efficient stakeholder engagement mechanisms.

Future research could extend the current study and assess the explanatory potential of the current study’s findings to other councils. Further work could also be undertaken in other contexts. For instance, corporate accounts of stakeholder engagement could be contrasted with stakeholder accounts of the engagement process (Rodrigue, 2014). The stakeholder engagement framework developed in this study could also be applied to study the stakeholder engagement practices of corporations. A critical dialogic approach in ensuring a fair and representative selection of stakeholders for engagement (Bebbington et al., 2007) is another research endeavour worth exploring.

This study has focussed on one variant of stakeholder theory, largely due to its exploratory focus. Future studies could utilise the other variants of the stakeholder theory and explore issues such as whether the normative foundations of stakeholder theory influence how stakeholders are actually engaged in practice. Similarly, assessment of the effectiveness of stakeholder engagement strategies through the use of the instrumental stakeholder theory would be a useful research investigation. Such a study could focus on indicators of quality and receptivity and assess whether the engagement with stakeholders does result in improved sustainability reports.

Notes
1. ICLEI-Oceania is an international, not-for-profit association of local governments and local government organisations that has made a commitment to sustainable development. It offers a range of technical support to local government bodies, including the development of sustainability reports and stakeholder engagement.
2. It is a new regulation that has been introduced for NSW local government to improve local councils’ long-term community, financial and assets planning.
References


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What would I know?

We rely enormously on experience. Just look at job advertisements and you see that higher levels of performance and responsibility demand more skill and often quite explicit mastery of knowledge that has been gained in specialised work settings. That makes sense: familiarity and competence rule. These do not arrive as a complete package in an instant, either; they take time, insight, and patience.

I have previously quoted from Alain de Botton’s *The Art of Travel* in this section and I am about to do it again. He writes:

> A danger of travel is that we see things at the wrong time, before we have had a chance to build up the necessary receptivity and when new information is therefore as useless and fugitive as necklace beads without a connecting chain (de Botton, 2014, p. 124).

Although de Botton is discussing travel here, we might as easily substitute the word “experience”. It could be experience that is a vital factor helping to engender knowledge of art, or automotive transport, or human relationships; albeit that they have different places in our lives. Another way of looking at it, which de Botton directly alludes to, is to consider our ignorance, our lack of knowing—which is not all our own fault but an accident of time and distraction. What opportunities to gain knowledge do we miss?

What then makes a good traveller, or teacher, or auditor, or researcher? And what makes a good learner? There are plenty of advisors on each score, though it is impossible to think about who might be the ultimate judge of such things, particularly since there is no universal agreement and since standards continually change. Still, we tend to look for a reasonable consensus on what marks the most appropriate level of performance, if not the pinnacle. Schools and universities frame their courses around set expectations but there is more. Part of the answer is in our mind-set, our readiness to step back from content and consider modes of learning; other people’s and our own.

Contemplating what makes a good auditor, for example, we can look to application of accounting standards but they alone would not save us. One might, to paraphrase de Botton, “see things at the wrong time” in an auditing job and not understand the significance of what is visible; not knowing what is “invisible”. That might relate to how new information could have an impact on, say, risk in operations when seen in a wider context, in the future of the client company. Of course, such situations of potential “blindness” are inevitable but they can be minimised with training. We can think about what we do with our uncertainty or ignorance. What principles of enquiry might we employ, for instance? To whom could we turn to ask for guidance? Is there another scenario where a similar factor was detected, and how important was it? Thinking of such things is a skill in its own right.
In education, much emphasis is being placed on differentiated learning. With this approach, we consciously move outside the one-size-fits-all mode of teaching and are sensitive to students’ varying styles of learning. It involves ongoing assessment of what works best for each student and looking at our capacity to respond productively to that knowledge. It requires patience (what you see with the advantage of your experience may not be immediately apparent to a relatively inexperienced colleague) and it requires going beyond the transfer of content. The equivalent in auditing is to think big and creatively.

We do not know what we do not know, to quote the truism, but that is not the end of matters. We can broaden our response to ask, “how can we deal with new knowledge in the way that best suits how we think, and how our students (formal or informal) think?” That might point the way to sharpening our critical thinking, collaborating with others (combining knowledge and skills), re-assessing the value of knowledge as it accumulates, and, most importantly, remembering that each of us is constantly learning. We owe it to our students to remember, too, that skills are honed through practice just as theirs are on the job.

But enough of my pontificating. We have two important and quite different creative works for you in this issue. Kerry Jacobs, Martina Linnenluecke, and Tom Smith combine their talents in a poem, “Otherwise”, that raises the matter of the imbalance in what women may be expected to do so that they can be regarded fairly as leaders in the workplace. In an imaginative piece of poetic writing, “A dialogue between accounting professors and two voices in my head”, Tarek Rana advances the empirical methodology of field mapping as a way of looking at notions of accountability.

Your own creative contributions can be submitted via ScholarOne (see below), and your e-mail correspondence is always welcome at: steve.evans@flinders.edu.au

Steve Evans  
*Literary Editor*

**Reference**
Otherwise

First we see the face
Yet strangely she is invisible
For me leadership is baked-in
While she must attend a course
And market her qualities
To prove her worth
I am heard while she remains quiet
My opinion carries a gendered weight
This is well past due for change
Perhaps an oath is required
Seeing past the obvious
To what is obvious to all
And so to treat, and know, and respect
To listen and to value
And forget our stupidity
The time is now past
For otherwise.

Martina Linnenluecke, Kerry Jacobs and Tom Smith
A dialogue between accounting professors and two voices in my head

Two accounting professors are casually talking over a few drinks after a formal dinner at conference a year ago. This is a conversation that I overheard while sitting next to them. I couldn’t help but take a note of the strange conversation about the struggle or contest between multiple notions of accountability and their logic behind them. However, I still could not get rid of two voices from my head.

Professor 1: Accountability is a notion Which ought to be accounting’s vision and mission And accountants’ main passion!
Professor 2: It is a big question to answer whether, Accountability shapes Accounting, or Accounting shapes Accountability, or Taken together they shape each other simultaneously!
Professor 1: It is not that hard at all. Accountability is an important notion for both private and public sector Which goes through, continuous construction of economic factors!
Professor 2: Oh, I disagree! Shall I call it accountants’ capital, habitus and doxic ability, or Academics and professional accountants’ inability to understand social space and its construction!
Professor 1: I would rather call it as economic rationalisation, and rational decision making. Professor 2: I would rather label it as legitimisation by politicisation and social construction. Indicating it as accounting’s or accountants’ limitation, position taking based on disposition.
Professor 1: I shall call it transparency!
Professor 2: I shall doubt it as scholastic fallacy of ideology and hegemony and lack of reflexivity!
Professor 1: Is that right? Why then it is so ambiguous, contradictory and changes with context?
Professor 2: One potential answer is essentially a matter of on-going discourse, political contest and symbolic violence. And subject of social (re)construction in a social space.

To this end, two voices in my head.

Voice 1: Eventually academics will ponder And the readers will wonder but There might be something that we could learn from the struggle of actors on the grounds Maybe even ones who are contesting each other most of the way through reflexivity and practical reasons

Voice 2: There are some academics who are playing by the rules of the scholastic power game in the King’s name Through Scholastic Fallacy, Ideology and Criticism For them Accounting, Auditing and Accountability are all the same economic game.

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