Contributions to Management Science

Fredrik Nilsson
Anna-Karin Stockenstrand

Financial Accounting and Management Control

The Tensions and Conflicts Between Uniformity and Uniqueness

Contributions to Management Science

More information about this series at
http://www.springer.com/series/1505

Fredrik Nilsson • Anna-Karin Stockenstrand

Financial Accounting and Management Control

The Tensions and Conflicts Between Uniformity and Uniqueness

Fredrik Nilsson
Department of Business Studies
Uppsala University
Uppsala
Sweden

Anna-Karin Stockenstrand
Department of Business Studies
Uppsala University
Uppsala
Sweden

ISSN 1431-1941 ISSN 2197-716X (electronic)
ISBN 978-3-319-13781-0 ISBN 978-3-319-13782-7 (eBook)
DOI 10.1007/978-3-319-13782-7
Springer Cham Heidelberg New York Dordrecht London

Library of Congress Control Number: 2015931645

© Springer International Publishing Switzerland 2015
This work is subject to copyright. All rights are reserved by the Publisher, whether the whole or part of the material is concerned, specifically the rights of translation, reprinting, reuse of illustrations, recitation, broadcasting, reproduction on microfilms or in any other physical way, and transmission or information storage and retrieval, electronic adaptation, computer software, or by similar or dissimilar methodology now known or hereafter developed. Exempted from this legal reservation are brief excerpts in connection with reviews or scholarly analysis or material supplied specifically for the purpose of being entered and executed on a computer system, for exclusive use by the purchaser of the work. Duplication of this publication or parts thereof is permitted only under the provisions of the Copyright Law of the Publisher's location, in its current version, and permission for use must always be obtained from Springer. Permissions for use may be obtained through RightsLink at the Copyright Clearance Center. Violations are liable to prosecution under the respective Copyright Law.
The use of general descriptive names, registered names, trademarks, service marks, etc. in this publication does not imply, even in the absence of a specific statement, that such names are exempt from the relevant protective laws and regulations and therefore free for general use.
While the advice and information in this book are believed to be true and accurate at the date of publication, neither the authors nor the editors nor the publisher can accept any legal responsibility for any errors or omissions that may be made. The publisher makes no warranty, express or implied, with respect to the material contained herein.

Printed on acid-free paper

Springer is part of Springer Science+Business Media (www.springer.com)

Preface

We are very happy to see this book in print. For us, it is an important book that merges ideas and areas of research that have now been integrated into something coherent. Even though the book was written in the last year, it has existed in our minds since the two of us started a research project in 2011. The fundamental questions of the book are not new but rather comprise what might even be called ‘eternal’ questions that can be found in various shapes within business studies. Looking at it from the perspective of accounting, this book is much about integration and about merging what are often treated as separate concepts and areas. Doing this, however, is a difficult endeavour. To our help we have had both scholars and practitioners who have been able to give valuable input and guidance in our analysis.

Financial support for the research on which the book is based has been received from the Swedish Research Council and the Jan Wallander and Tom Hedelius Foundation, as well as the Tore Browaldh Foundation. We are most grateful to our funders. We are also very thankful to a number of people who in different ways have helped to refine and develop the ideas presented in the book. Econ. Lic. Per-Ove Zetterlund, Director at PricewaterhouseCoopers in Stockholm, provided us with many detailed comments, especially on our discussion of financial instruments. Dr. Niklas Sandell, Assistant professor at Lund University, posed intriguing questions which helped us clarify our thoughts and reasoning.

We have also received comments and suggestions on the working paper that was our first attempt to present the ideas that the book is built on (Nilsson and Stockenstrand 2013). We would like to thank the participants at the European Network for Research in Organisational and Accounting Change (ENROAC) in Jyväskylä and the 22nd Nordic Academy of Management Conference (NFF) in Reykjavik. We are particularly grateful for the many valuable comments from members of the Centre for Empirical Research on Organizational Control (CEROC) at Örebro University. The interactions with our PhD candidates—Jason Crawford, Shruti Kashyap and Marcus Tirmén—have also been an inspiration. The practitioners interviewed in the explorative study have been instrumental for our comprehension of the intricacies of the relationship between financial accounting

and management control—thank you for sharing your knowledge with us. Finally, we would like to thank Dr Donald MacQueen for his assistance in editing the language.

As already pointed out, this book is the result of a journey that we started in 2011. More specifically, the book is part of a research project that the two of us developed with the aim of studying accounting and control in banks with a focus on how financial accounting affects management control. This project will also enable us to further develop and refine the theoretical framework and the tentative conclusions presented in the book. We are sure that in a few years we will know much more about the tensions and conflicts between uniformity and uniqueness – especially in the banking sector. In that sense this book is the first leg of a long journey of research and learning.

Uppsala, Sweden
September 2014

Fredrik Nilsson
Anna-Karin Stockenstrand

Author Presentation

Fredrik Nilsson has been Professor of Business Studies, especially accounting at Uppsala University since 2010. Before that he was Professor of Economic Information Systems at Linköping University. His research focuses on how information systems (e.g. management control systems, financial accounting systems and production control systems) are designed and used to formulate and implement strategies. Fredrik has published many books, book chapters and scientific articles in this field of research. He is currently studying the relationship between strategies, financial accounting and management control in banks.

Anna-Karin Stockenstrand is Assistant Professor in the Department of Business Studies at Uppsala University. Her research concerns transparency and accountability in organizations and the long- and short-term effects on internal processes from adaptation to external demands. She is currently conducting research on the effects of financial reporting standards on different parts of the management control function in banks. Anna-Karin has written a number of scientific articles as well as book chapters and is also author of two textbooks in financial accounting.

Contents

1 The Objectives of Financial Accounting and Management Control 1
1.1 Introduction 1
1.2 A Stakeholder Perspective 3
1.3 Stakeholders and Value Creation 4
1.4 Management Control and the Demand for Uniqueness 6
1.5 Financial Accounting and the Demand for Uniformity 7
1.6 The Tensions and Conflicts Between Uniformity and Uniqueness 9
1.7 Purpose of the Book and Intended Readership 12
1.8 A Note on Methodological Considerations 14
1.9 The Organization of the Book 15

2 Theoretical Foundations 17
2.1 Introduction 17
2.2 The "Relevance Lost" Debate 18
2.3 Introducing a New Financial Accounting Regime in the EU 21
2.4 Models and Frameworks for Analysing and Managing Relationships Between Accounting Systems 25
2.4.1 The Performance Pyramid 25
2.4.2 The Balanced Scorecard 26
2.4.3 Activity-Based Costing 27
2.4.4 The Corporate Responsibilities Continuum 28
2.4.5 The Integrated Reporting Framework 30
2.4.6 The Taipaleenmäki and Ikäheimo Framework 31
2.5 Our Theoretical Framework 34
2.5.1 Demands for Uniqueness 36
2.5.2 Demands for Uniformity 39

2.5.3 Possible Tensions and Conflicts Between Uniformity and Uniqueness 45
2.6 Conclusions and Implications 49

3 Financial Accounting Standards: Some Examples 51
3.1 Introduction 51
3.2 Segment Reporting 52
3.2.1 Background 52
3.2.2 Tensions and Conflicts Between Uniformity and Uniqueness 53
3.3 Goodwill Accounting 57
3.3.1 Background 57
3.3.2 Tensions and Conflicts Between Uniformity and Uniqueness 59
3.4 Business Combinations 63
3.4.1 Background 63
3.4.2 Tensions and Conflicts Between Uniformity and Uniqueness 64
3.5 Financial Instruments: Classification and Measurement 66
3.5.1 Background 66
3.5.2 Tensions and Conflicts Between Uniformity and Uniqueness 68
3.6 Conclusions and Implications 72

4 How Financial Accounting Affects Management Control 77
4.1 Introduction 77
4.2 Strategic Planning 79
4.2.1 Segment Reporting and Effects on Strategic Planning 80
4.2.2 Goodwill Accounting and Effects on Strategic Planning 81
4.2.3 Business Combinations and Effects on Strategic Planning 83
4.2.4 Financial Instruments and Effects on Strategic Planning 85
4.3 Budgeting 87
4.3.1 Segment Reporting and Effects on Budgeting 88
4.3.2 Goodwill Accounting and Effects on Budgeting 90
4.3.3 Business Combinations and Effects on Budgeting 91
4.3.4 Financial Instruments and Effects on Budgeting 92
4.4 Reporting and Analysis 94
4.4.1 Segment Reporting and Effects on Reporting and Analysis 95
4.4.2 Goodwill Accounting and Effects on Reporting and Analysis 96
4.4.3 Business Combinations and Effects on Reporting and Analysis 98
4.4.4 Financial Instruments and Effects on Reporting and Analysis 99

4.5 Rewards and Compensation 101
4.5.1 Segment Reporting and Effects on Rewards and Compensation 102
4.5.2 Goodwill and Effects on Rewards and Compensation 103
4.5.3 Business Combinations and Effects on Rewards and Compensation 105
4.5.4 Financial Instruments and Effects on Rewards and Compensation 106
4.6 Conclusions and Implications 108

5 Concluding Reflections 111
5.1 Introduction 111
5.2 The Framework Revisited 112
5.2.1 Demands for Uniqueness 113
5.2.2 Demands for Uniformity 115
5.2.3 Tensions and Conflicts 117
5.3 Relevance Lost or Regained? 120
5.4 Conclusions and Implications 124

References 129

Chapter 1
The Objectives of Financial Accounting and Management Control

1.1 Introduction

This book is about financial accounting and management control and how these two information systems are related as well as how their objectives conflict. Financial accounting has lately become prominent in the public debate, both among practitioners and researchers. This is seen for example in the increased interest in the role and effect of fair value accounting. Some researchers even discuss to what extent the most recent financial crises could be blamed on the increased amount of fair values in the financial reporting of large companies (cf. Laux and Leuz 2009a; Pozen 2009; Barth and Landsman 2010; Magnan and Markarian 2011).[1] At the same time the needs of owners and funders as well as other users of financial accounting information are increasingly being put forward by accounting standard-setters in their rationales for issuing new standards. What can also be noticed in these standards is a tendency to enable owners and funders to gain insight into the strategy and management control system of a specific company. One example is the accounting standard for segment reporting (IFRS [International Financial Reporting Standards] 8 *Operating Segments*), which has been introduced in order for owners and funders to have better insight into how the company is actually managed in practice. Taken together, this brings us to the core question of the book—namely whether financial accounting and management control are two systems that are compatible and possible to integrate. Many researchers and practitioners call for their integration (e.g. Bhimani and Soonawalla 2005; Taipaleenmäki and Ikäheimo 2013); however, we need to know much more about

[1] For a general discussion about the role of accounting in the financial crisis starting in 2007–2008, see for example Magnan and Markarian (2011) and Kothari and Lester (2012). For a detailed discussion about the role of banks in financial crisis and especially the role of regulations, see for example Knutsen and Lie (2002) and O'Connor (2010).

© Springer International Publishing Switzerland 2015

F. Nilsson, A.-K. Stockenstrand, *Financial Accounting and Management Control*, Contributions to Management Science, DOI 10.1007/978-3-319-13782-7_1

how they are actually related and to what extent the conflicting objectives of these two information systems can be reconciled.

A basic assumption in many textbooks is that financial accounting and management control are the two most important information systems in a company (besides the overall corporate governance system). These two information systems are used for decision-making in at least two ways. The financial accounting system is used for evaluating value creation and ultimately whether the company is competitive both on the product and capital markets. At the most fundamental level the objective of financial accounting is to give the owners and funders uniform and comparable information of the company's value creation. The management control system (a wider term than management accounting) is used in the process of creating a strong competitive position for the company by providing relevant information for strategic, tactical and operational decisions. The objective of management control is therefore to give the board, senior executives and employees (including lower-level managers) unique information for strategy formulation and implementation. These two information systems are thus designed and used for decision-making by different stakeholders with different information needs.

The conflicting objectives of financial accounting and management control (i.e. between uniformity and uniqueness), is well known among both practitioners and scholars. One possible negative effect, often mentioned, is the risk of financial accounting affecting management control design and use, making it less relevant for decision-making at the company level and eventually affecting competitiveness and value creation (cf. Johnson and Kaplan 1987). Therefore it is surprising that the conflict between these two information systems has not been discussed in more detail in the literature. For example, in a recent review of papers in the area of accounting and control of banks, covering 18 top accounting journals over the period 2002–2012, very few papers treated the relationships between financial accounting and management control (Crawford et al. 2014). However, this does not mean that no published research has been done. A notable and recent example is a conceptual paper by Taipaleenmäki and Ikäheimo (2013) discussing information technology and how it affects the convergence of financial accounting and management accounting. More examples of studies are presented in the following chapters.

In this book, we have a broad perspective, problematizing the management control system as a whole, including everything from strategy formulation to implementation (i.e. strategic planning, budgeting, reporting and analysis, rewards and compensation). The book is a development of a framework describing the relationship and possible tensions and conflicts between financial accounting (demands for uniformity) and management control (demands for uniqueness) first presented in a paper by Nilsson and Stockenstrand (2013). Our aim is to understand how the management control system as a whole is affected by financial accounting, but also how management control affects financial accounting. We will now proceed to discuss the different stakeholders and what their demands for information look like and why they differ.

1.2 A Stakeholder Perspective

In the literature on management control, and especially financial accounting, the owners are considered to be an important stakeholder. The reason is that the owners are providing the company with funds and will receive a profit or have to cover a loss. In that respect the owners are also the stakeholders taking an economic risk (cf. Scott 2009). The owners (as well as potential investors) are a group of stakeholders that can be found outside the company. Even though the literature focuses on owners we will also talk about other stakeholders (e.g. customers and employees) and especially those that provide the company with funds, such as lenders of different kinds. The reason is that these funders are also important users of financial accounting information. We will therefore mostly use the term "owners and funders".

In the 1990s considerable attention was focused on how value was created for owners and especially how it should be measured. This influential stream of literature—called Value Based Management (VBM) (see for example Rappaport 1998)—has introduced such measure as Total Shareholder Return, defined as return on investment, or share price appreciation plus total dividends (Donovan et al. 1998, p. 28) and Economic Value Added, defined as "the residual income that remains after operating profits cover a full and fair return on capital (i.e., the cost of capital)" (Stewart 1999, p. 742). These measures have been developed with the sole purpose of capturing value creation from an owner perspective in companies that are quoted on a stock exchange. A VBM perspective considers the owner to be the most important stakeholder and the undisputable principal of the company. Other stakeholders are only considered to be important if they affect the capacity to create value for the owners. In that respect a VBM perspective is largely based on an instrumental view of other stakeholders in the company.

Even though the VBM perspective focuses on quoted companies, this stream of literature has also contributed to putting owners of all types of organizations in the limelight (in the book we will use the term "company" but most of the reasoning applies to most organizations). However, traditionally the term *accounting* in itself has not been a concept where the use of information by stakeholders outside the organization has been the main focus. In his classic book *Accounting Theory* Kam (1990) define accounting using the Committee on Terminology of the American Institute of Accountants' definition[2]; as:

> Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof. (ibid., p. 33)

This definition takes its departure in the actual work with accounting within the company. Socea (2012) argues that decision-making research has been important and had a long history in accounting, albeit with a strong focus on management accounting and not as much on financial accounting. The idea that financial accounting is mainly for external stakeholders has been strengthened further by

[2] According to Kam (ibid) the definition below can be found in "Accounting Terminology Bulletin No. 1, 'Review and Resume,' 1953, paragraph 9".

the fact that owners have been pointed out as the most important stakeholders and users of financial accounting information. The trend in financial accounting has been that the interpretation of recorded and classified information should not primarily be interpreted by management, but that the company should just report as many details as possible about their activities so that owners can make use of that information through their own interpretations. This has been called the expansion of the objectives of financial accounting information (Socea 2012).

In some forums, the sole focus on the owner as the most important stakeholder has also been challenged. Under the banner of "Corporate Social Responsibility" a more critical stance has been taken towards the view of the company as mainly existing to create value for shareholders. Researchers in this field do not acknowledge the view—held by many VBM proponents—that other stakeholders are important only if they contribute to satisfying the needs of the owners. Instead they claim that companies have a wider responsibility for the sustainable development of society at large. The company must therefore act in a responsible and ethical manner in creating value for the owners as well as other important stakeholders, such as customers, suppliers and employees (Borglund et al. 2012). Today corporate social responsibility has gained considerable influence and challenged the sole focus on owners. As a result many large companies have included information in their annual reports on how they act as a responsible "corporate citizen". The best example is probably the increased attention on so-called environmental reports, showing how the company affects the environment (Frostenson et al. 2012). But many other areas are also covered, which is shown in a recent literature review of corporate social responsibility practices (Kavitha and Anita 2011, p. 45):

> CSR now-a-days covers almost all issues like the use of child labor; inequality of employment; environmental impact; involvement in local community; products' safety; company cultures; brand image and reputation. Apart from this, companies are now disclosing these activities in their annual reports, and one of the parameters to judge the performance of a company is CSR reporting.

This trend is also evident in a very large international survey of CSR reporting that shows that companies consider stakeholders other than owners to be important (KPMG 2011). In this book we adhere to this view, acknowledging the importance of owners and funders as well as other influential stakeholders—both outside (e.g. regulators, analysts) and inside (e.g. senior executives and employees) the company (cf. Anderson et al. 2013, p. 9). These stakeholders have different information needs that, as will become evident, affect the design and use of both the financial accounting and management control system as well as the tensions and conflicts between these two information systems.

1.3 Stakeholders and Value Creation

A high level of value creation is considered to be the proof of a company being competitive (Porter 1985; Jannesson et al. 2014). As discussed in the previous section a company has many important stakeholders, and it can be expected that

they view the creation of value in quite different ways. The customers will evaluate whether the value of the products exceeds the price (we will use the term "product" instead of "product and services" throughout the text). The employees will evaluate their monetary compensation and the level of self-fulfilment. And the owners will evaluate return on investment (i.e. total shareholder return in a quoted company). In their discussion of value creation for these three stakeholder groups Donovan et al. (1998, p. 18 f.) stress the importance of finding a balance between them:

> Managing for enterprise value is a big departure for many managers and, indeed, business theorists. They believe that catering to one or two constituencies will automatically guarantee that the others will be taken care of. This is a grave mistake. Focusing on a single stakeholder is simplistic and shortsighted. You simply cannot sustain the creation of value if the needs of shareholders, customers and employees are not aligned. The importance of this becomes clear when it is recognized that a company's value and, by extension, its share price, are reflections of the company's ability to generate value over a longer period of time.

Without doubt the most important aspect when evaluating the ability to create value is the time period chosen. There are many examples of companies that have been praised for their excellence only to find that they are in a state of economic crisis a couple of years later (cf. Peters and Waterman 1982). Some researchers even claim that success and value creation are to a large extent plain luck. In a study of 287 allegedly high-performing companies "about one in four of those firms was likely to be remarkable; the rest were indistinguishable from mediocre firms catching lucky breaks" (Raynor et al. 2009, p. 19). To be able to truly understand how value is created and whether it is sustainable, the company must be studied for a very long period of time, often more than a decade (cf. Nilsson and Rapp 2005; Jannesson et al. 2014) and several different stakeholders need to be included (cf. Donovan et al. 1998).

One example of a company that has managed to create value for many different stakeholders is Svenska Handelsbanken (a Swedish bank). It is considered to be one of the most cost-effective banks in Europe. The bank has established a strong and differentiated value-proposition on the market, with a large network of bank affiliations all over Sweden creating a close relationship to the customers and the local community. A combination of centralization and decentralization, as well as a very tight follow-up of costs, has contributed to the strong financial position of the bank and its ability to create value for the owners over a long period of time. The bank has also become famous for their profit-sharing scheme in which the employees will be rewarded if the bank has a better economic performance than other banks in Sweden. So far this profit-sharing scheme has been very successful and created a great deal of value for the employees (Lindsay and Libby 2007). Through the profit-sharing scheme the foundation invests the shared profits in Handelsbanken shares. At the end of 2013 the foundation controlled 10.31 % of the votes, representing 10.14 % of share capital (Handelsbanken 2013).

In conclusion, besides being very cost-effective, Handelsbanken has managed to align the different needs of customers, employees and owners and thereby shown how such an alignment contributes to creating a competitive advantage in the

marketplace as well as creating value over a long period of time. The reason for this is attributable to a distinct business strategy and a unique management control system designed to implement and develop the strategy. In the following section we will give a brief introduction to the role of strategies in creating competitive advantage and value.

1.4 Management Control and the Demand for Uniqueness

In order to create value, at least in the long term, the company must have an idea of how this should be accomplished. Research has shown the importance of a focused strategy in which the products offered contribute to the creation of a strong market position. Porter argued, as far back as the early 1980s, that the company must choose between basically two generic types of strategy—differentiation (competing with unique product characteristics) or cost leadership (competing with low production costs). Companies that try to combine these two strategies, or quite simply do not have a very clear idea about how their products should compete, risk being "stuck in the middle". Such a position is not a strong foundation to build competitive advantage, and it will not create value either for the owners or other stakeholders, such as customers and employees (Porter 1980, 1985).

Porter's reasoning, especially regarding the importance of how the products are positioned on the market, is still valid today. Therefore, in large corporate groups it is the different business units that create competitive advantage and value, not the company. This fact has tremendous impact since it will make both strategy formulation and implementation much more demanding owing to difficulties in aligning strategies at different organizational levels. Research has shown that successful corporate groups are characterized by mutually consistent corporate, business and functional strategies—what Nilsson and Rapp (2005) call a state of strategic congruence (Goold et al. (1994) also discuss strategic congruence, but they use the term "Heartland"). Nilsson and Rapp (2005, p. 49 f) explain how strategic congruence is a source of competitive advantage in itself:

> With the corporation's business based on a common logic, the mechanisms that create value are clearly discernible. One advantage of such focusing is that it permits integrated planning and follow-up, thus making it easier to co-ordinate the goals and strategies of the different organizational levels. Among other benefits, corporate management can ensure that synergies are exploited and can participate more effectively in the development of the individual business units. Thus, strategic congruence can be assumed to improve the possibilities of matching strategies with the environment and of establishing a system of control that supports the implementation of these strategies.

Porter (1996), alongside other leading strategy researchers, has a similar view of the importance of formal structures and processes.[3] This does not exclude that some

[3] Mintzberg (2000) provide an overview of the most influential strategy schools. Three of them—the design school (strategy as a process of conception), the planning school (strategy as a formal

strategies develop in a more unstructured and emergent way (Mintzberg 1987). Probably, most successful strategies are a result of both formal and informal processes. We do not, however, believe that companies can sustain a strong competitive position and create value without a formal planning and follow-up process. An important theoretical starting point is therefore that the company must have a management control system with an appropriate design and use to be able to formulate competitive strategies, implement them successfully and account for their ability to create value. Since the strategies pursued by the company are unique—at least to some extent—the management control system must also be unique in order to satisfy the information needs of the managers and employees trying to implement the strategy (for an overview see for example Nilsson et al. 2011; Jannesson et al. 2014). As mentioned earlier such an information system is instrumental in creating competitive advantage and value for important stakeholders.

Today there are many studies that use a contingency theoretical approach and focus on finding out what design and use of the control system is most appropriate given a specific strategy. Contingency theory is rooted in the field of organization studies in the early 1960s. Miller and Power (2013, p. 569) define it in the following way: "'Contingency theory', is the label that came to be given to this set of studies that showed that there is no universal way of designing organizations." In line with the same reasoning there is no single management control system that fits all organizations. In Chap. 2 we will give a short overview of some recent research in that area and also discuss why it so important that management control systems are uniquely designed and used. In the following section we will discuss the financial accounting system and how it is used for evaluating value creation and ultimately whether the company is competitive, in other words whether the company has been successful in implementing the strategies.

1.5 Financial Accounting and the Demand for Uniformity

To be able to evaluate whether the strategy of a company is creating value for its owners (and other stakeholders) they must be provided with relevant information. Using terms from principal-agent theory (PA theory) (see for example Jensen and Meckling 1976), the owner (the "principal") has employed a board and an executive (the "agents") to manage the company (we will discuss some aspects of principal-agent theory further in Chap. 2). However, there are reasons to believe that the agent does not always act in the best interest of the principal and instead try to maximize value creation from his/her own perspective (e.g. power and monetary rewards). Because the agent cannot be entirely trusted, the principal must follow up

process) and the positioning school (strategy as an analytical process)—subscribe to the view that formal structures and processes are important in strategy work.

and scrutinize the activities of the agent and especially the results of these activities. For this reason the follow-up should be done in such a way that information asymmetries between principal and agent are reduced to a level which makes it possible to hold the agent accountable for his/her actions (cf. Roberts and Scapens 1985). As already mentioned, the primary purpose of financial accounting is to give the owners and funders uniform and comparable information about the company's value creation, and it is therefore considered to be the foremost tool for surveillance of the board and the senior executives. Miller and Power (2013, p. 572) describe how financial accounting has become so influential in this respect:

> As the corporate economy grew in the first half of the twentieth century, accounting faced the issue of the growing distance between providers of capital (shareholders) and managers. This "agency problem" created new institutional pressures on accounting at the enterprise level. Far from being a private matter of the owner-manager, a sub-field of accounting—which we now call financial accounting and reporting—was set on course to be a mechanism by which professional managers would be accountable to providers of capital, a mechanism enshrined in law.

The authors also point to the strong tendency to make the performance of companies comparable as well as commensurable. Making financial accounting reports more uniform would enhance the opportunities for the owners (the principals) to compare value creation of their company with similar companies. Even though this tendency is stronger than ever, it can be traced back to the 1950s (Young 2006). With harmonized accounting standards, the rules for how to account for a specific transaction would not differ between companies since the accounting principles and praxis would not vary (at least that is the ambition). As a consequence it can be expected that transparency of the financial reports would increase—or in the words of PA theory, would reduce information asymmetries between principal and agent. That would increase the owner's ability to hold the board and senior executives accountable as well as help them to make wise investment decisions (Roberts 2009). The demand for uniformity is also a result of ambitions to reduce the level of complexity when describing and comparing companies (Messner 2009). However, this view of financial accounting as some sort of neutral mirror of what is happening in the organization does not lack critics. Miller and Power (2013) argue that accounting (including management control) has a transformative capacity:

> While accounting is profoundly technical, its role in patterns of economizing means that it is also and simultaneously profoundly institutional, in the sense of exhibiting styles and patterns of thinking about organizations and management that may be quite stable, and that are supported by habituated routines and work practices which realize and reinforce those styles. (Miller and Power 2013, p. 561)

Miller and Power (ibid.), as well as many other researchers, have shown that there are reasons to believe that accounting not only mirrors what has happened but actually affects what is going to happen. There are also researchers who claim that the wish for full transparency is more or less a fantasy never to be realized (Roberts 2009). Also, researchers are sceptical about

> whether the introduction of standardized accounting rules (such as IFRS), particularly those that require significant levels of judgment (such as fair value accounting) will actually result in effective standardization of accounting practice. (Skinner 2008, p. 236)

Despite this, and as discussed by Brandau et al. (2013), referring to institutional theory, there are strong forces such as powerful international organizations (e.g. the International Accounting Standards Board [IASB]) that strive for harmonization of accounting standards in order to achieve what they believe will lead to a higher degree of transparency and make comparisons between companies possible. According to Brandau et al. (2013, p. 468) "Institutional theory explores the impact of rules, social norms and rationalised concepts on formal organisational structures, practices and procedures and has become particularly important in the area of management during the last 30 years (Meyer and Rowan 1977; Scott 2008)". We will discuss some aspects of institutional theory further in Chap. 2.

It should also be noted that there is research showing that comparability lowers the cost of gathering accounting information and enhances the quality of accounting information provided to business analysts (e.g. De Franco et al. 2011). In this book we develop this line of reasoning by critically examining the demands for uniformity and how financial accounting standards can be expected to affect strategies and control systems as well as the other way around. We will now turn to some of the studies describing the potential tensions and conflicts between the demands for uniformity and the demands for uniqueness.

1.6 The Tensions and Conflicts Between Uniformity and Uniqueness

The relationship between uniformity and comparability has been discussed for several decades, not least in the accounting regulation literature. Zeff (2007) for example describes the debate in the US in the 1950s and 1960s that revolved around the issue of uniformity and whether uniform accounting methods would lead to better comparability (Uniformity in Financial Accounting (1965), cited in Zeff 2007). Some accounting firms at that time argued strongly that uniform accounting methods would be a necessity in order to achieve comparability. One accounting firm, however, argued that the individual circumstances of each firm had to be taken into account in order for financial accounting to achieve more genuine comparability. Zeff (2007) concludes that the debate in the USA was never resolved; however different regulatory bodies and cultures can have different perspectives on the need for uniformity as a way of achieving comparability. For example, he explains that the US Securities and Exchange Commission (SEC) has long been a proponent of uniformity. In the rest of this book, we will discuss the possible tensions and conflicts between uniformity and uniqueness. However, sometimes, we will also discuss it using the term comparability.

We can thus conclude that the tensions and conflicts between uniformity and uniqueness is well known both among practitioners and scholars. Furthermore, the tensions and conflicts are often described as something that has a potential negative impact on the design and use of financial accounting and management accounting[4] in general, and the integration of these two information systems in particular (see for example, White et al. 2011). Even though the tensions and conflicts have been observed in some early writings—for example Clark (1923) (cited in Joseph et al. 1996)—it was the study by Johnson and Kaplan (1987) that started a very influential debate discussing the lost relevance of management accounting (the "Relevance lost debate", named after the title of their book). The authors argue that financial accounting became more important than management accounting and also affected the design and use of the latter. The consequence was that management accounting was using data that was too aggregated and arrived too late, making it less relevant for strategic, tactical and operational decision-making. In their last chapter the authors conclude (ibid., p. 260):

> The obsolescence of management accounting systems has not occurred overnight. The systems whose intellectual roots can be traced to events 60 to 100 years ago, worked well for the times in which they were designed. We have speculated that the dominance of financial accounting procedures, both in education and in practice, has inhibited the dynamic adjustment of management accounting systems to the realities of the contemporary environment. These realities, including remarkable expansions of information technology, a more virulent global competition, shortened life cycle of products, and innovations in the organization and technology of operations, have all contributed to the new demands and new opportunities for corporate management accounting systems.

Even though the book by Johnson and Kaplan described American companies it also received considerable attention in Europe. Especially in the UK the influential organization Chartered Institute of Management Accountants (CIMA) initiated several book projects with the aim of discussing the development of management accounting (Bromwich and Bhimani 1989, 1994). These books helped to differentiate the message by Johnson and Kaplan (ibid.) showing signs of management accounting also developing in the direction of supporting decision-making for managers (e.g. strategy formulation and implementation). A CIMA-sponsored report of 308 UK management accountants in industrial and commercial companies was also launched to specifically investigate the link between financial accounting and management accounting (Joseph et al. 1996). Considering the claims by Johnson and Kaplan (1987) almost a decade earlier, the results were surprising: The study showed that financial accounting did not affect management accounting to any great extent. However, large companies and quoted companies showed a higher degree of influence. The authors conclude with a reflection over some conflicting results (Joseph et al. 1996, p. 91 f).

[4] Most of the studies reviewed use the term "Management accounting" instead of "Management control". We will discuss the implications of this in more detail in Chap. 2.

> Although the management accountants who responded to the survey do not seem to believe that management accounting is dominated by financial reporting, they use integrated financial accounting and management accounting systems and have little discretion in the content of their management reports. The latter being dictated by the requirements of financial reporting to head office.
>
> Such seemingly contradictory findings may be due to managers and management accountants perceiving management information needs in terms which reflect a financial accounting view of the organization and of its performance. In other words, the lack of belief that external reporting dominates internal accounting may simply be a reflection of the success with which external requirements have become an established part of the routines of information gathering and reporting within organizations and an essential part of management thinking on appropriate information for decision making. Issues of this nature, however, cannot be investigated using the survey methods of the research reported here.

These reflections are very interesting and, as the authors point out, could be related to the methodology used (a questionnaire). Therefore they recommend future research to use longitudinal case studies to be able to capture the more “subconscious” perceptions of the possible relationships as well as tensions and conflicts of financial accounting and management accounting. There is also reason to believe that UK companies are not necessarily exposed to the same external forces as companies in the US, making it difficult to compare the results from the study by Johnson and Kaplan (1987) and the study by Joseph et al. (1996).

Drawing on a historical study of the divergence and convergence of financial accounting and management accounting by Ikäheimo and Taipaleenmäki (2010) it is clear that US companies have been exposed to much stronger converging pressures than companies in some European countries (i.e. Finland and Germany). In the US there were strong economic pressures to strive for convergence starting as early as the 1930s. Germany had a long tradition of separating financial accounting and management accounting, since the former was heavily influenced by tax legislation. In addition, influential scholars were deeply involved in the development of management accounting innovations. Finland was heavily influenced by German accounting thinking and as a consequence companies had a low level of convergence.

In the 1990s the level of convergence starts to increase as a result of a rapid development of new and advanced information technology affecting the design and use of information systems in a profound way (Taipaleenmäki and Ikäheimo 2013). Integrated Enterprise Systems were introduced with the aim of creating an integrated planning and follow-up system for large companies (Rom and Rohde 2007). This development increased the level of convergence of financial accounting and management accounting. Another important development was the ever-increasing efforts to harmonize financial accounting and make the financial reports more comparable between companies. These efforts culminated in a decision by the Parliament and Council of the European Union that quoted companies should introduce IFRS by 2005 (Jones and Luther 2005). Several years later there are evidence that this change has affected how CFOs look upon the need to integrate financial accounting and management accounting. For example, based on a study of

how 17 Swedish companies made their transition to IFRS in 2005, Hjelström and Schuster (2011, p. 84) conclude that:

> these two sets of accounting should be coordinated as far as possible because of significant internal communication costs arising from dual systems. Applying different accounting policies in the two systems was clearly perceived as an undesirable last resort.
>
> These findings raise questions about standard-setters' views on the role of management's information needs for financial reporting standards. In their work on a new conceptual framework the International Accounting Standards Board argues that information that is useful to capital providers also should be useful to management. Not denying that, we think that you might equally argue that information that is useful to management also should be useful to capital providers.

Hjelström and Schuster have captured a tendency that is growing strong: that there is much to be gained by integrating the two information systems. The quotation also reveals the view of influential policy makers that the conflict between the demands for uniformity and the demands for uniqueness is not that great—or can at least be solved. Even though some empirical studies do exist, which we will present more in detail in Chap. 2, the evidence for such a statement, as mentioned, is often anecdotal or explorative in character. At the same time there are some recent efforts to conceptualize the tensions and conflicts, such as the paper by Taipaleenmäki and Ikäheimo (2013). Based on a literature review, the authors' own experience and informal discussion with several CFOs, they develop a framework that can be used to analyse the convergence of financial accounting and management accounting and the role of IT in that process. Their paper builds on Hemmer and Labro (2008) and is a welcome contribution. We do believe, however, that the field needs more conceptual work of this kind, linking the conclusions to well-established theoretical and empirical assumptions of what affects financial accounting and management control and the interrelationship between these two information systems.

1.7 Purpose of the Book and Intended Readership

The aim of this book is to address the void in the literature identified in the previous sections of the chapter by providing an explorative and tentative analysis of the complex relationship between financial accounting and management control. We would like to stress that our ambition is not to give a definitive or a final answer to what this relationship looks like. Our ambition is to provide an analysis that, though explorative and tentative, can be used to enhance our understanding of the conflict between demands for uniformity and uniqueness and how it can be expected to affect financial accounting and management control. In other words, the book is conceptual in character, and since the conclusions are tentative, they should be tested in future research.

At a more detailed level, the analysis and results are to a large extent the result of reasoning in which we build on earlier conceptual and empirical studies of how

financial accounting standards affect not only the annual report but also the control system. The analysis will also show how the complexity of these standards can lead to a situation in which it is possible to choose how to present the company in the annual report. In such a situation management control can be assumed to affect financial accounting instead of the other way around. These types of complex relationships, which can be expected to influence the design and use of both financial accounting and management control, are of fundamental importance to our understanding of how these systems are affected by external and internal forces. Therefore this book has a rather broad intended readership.

First, we believe that the book should be of interest to advanced undergraduate students and graduate students. Today there are numerous books in the fields of financial accounting and management control. Few books, at least to our knowledge, integrate these two areas. This book could therefore be a valuable addition to the more traditional textbooks that exist today. By discussing the conflict and tension between the two information systems, students should be able to better understand (a) what affects the design and use of financial accounting; (b) what affects the design and use of management control; (c) how financial accounting and management control are interrelated; and (d) what possible tensions and conflicts this interrelationship gives rise to.

Second, an increased understanding of the forces affecting financial accounting and management control should be of importance to practitioners working in the broad area of accounting and control. One example of such a practitioner is the Chief Financial Officer (CFO), who usually has an overall responsibility for the design and use of the two information systems. The book should also be of interest to more specialized accounting practitioners. It discusses some important developments in the area of financial accounting, for example the effects of harmonization and principles-based accounting, and how that can be expected to affect in what way companies are controlled and managed. The introduction of IFRS has had both intended and unintended effects—especially evident in the financial sector. These matters are of great concern to the advanced practitioner.

Finally, the book should be of interest to all researchers that have an interest in understanding the interrelationships as well as possible tensions and conflicts between financial accounting and management control. It addresses an area that has always been important and has become even more important after the introduction of IFRS, since that accounting regime has the potential to both increase and decrease the conflict. The framework and the tentative conclusions could also be used as a starting point for future research testing and expanding the analysis provided in this book. In that respect we hope that the book could inspire more research in an area in which there is an urgent need for many more studies, especially empirical ones. As mentioned, our empirical knowledge of how financial accounting and management control affect one another in large and complex companies is rather limited.

1.8 A Note on Methodological Considerations

To fulfil the aim presented in the previous section a theoretical framework has been developed. It is presented in Fig. 2.3 and is a modified version of the original framework by Nilsson and Stockenstrand (2013). It is intended as a contribution to the stream of literature discussed in this book. The development of the framework is the result of a long research process that started with a broad and explorative study in which practitioners with deep knowledge of the design and use of accounting and control systems and their interrelationships were interviewed. We interviewed one group accounting officer for a large Swedish bank, one group controller for a large Swedish multinational company, one financial analyst, one senior manager for the Swedish Financial Supervisory Authority, two senior certified public accountants and one financial accounting expert. In parallel, the first phase of our literature review was conducted. The result of these efforts was presented in a conference paper (ibid.) and was also used as the theoretical starting point for the two authors' research project studying accounting and control in banks with a focus on how financial accounting affects management control.[5] Based on the explorative study, and an even more extensive literature review, the conceptual work of refining the framework commenced. It resulted in the version that can be found in Fig. 2.3.

It should be noted that the literature review that the book is based on is not claimed to be exhaustive. Since the theoretical framework used covers both financial accounting and management control there is an almost infinite number of publications that in some way or the other (at least implicitly) could be claimed to be relevant to a discussion of these information systems and their relationships. We therefore decided to focus on publications that explicitly discuss this relationship and the possible conflict between financial accounting and management control. The database Business Source Premier was used for identifying articles. In the next step the reference list of identified articles was scrutinized to identify other articles and publications. In addition, the literature identified in an overview conducted by us and three PhD candidates was scrutinized in order to find suitable articles for this book (Crawford et al. 2014). As earlier mentioned this overview focuses on accounting and control in banks and uses the framework of Nilsson and Stockenstrand (2013) to categorize and analyse the studies identified. The review covered 18 top-ranked accounting journals over the time period 2002–2012. Of the articles identified in the review we found fewer than ten articles that were especially suitable for our purposes. Finally, we use some fundamental insights and analytical concepts from contingency, principal–agent and institutional theory to enrich our

[5] We believe that banks are especially interesting to study since there are few, if any, industries that are as highly regulated as the financial sector. Hence the tension, and possible conflict, between the demands for uniformity and the demands for uniqueness is ubiquitous in this context. Banks are also very much affected by the introduction of IFRS and new IT solutions. As mentioned, both of these trends have the potential to affect integration efforts (see for example Ewert and Wagenhofer 2007; Taipaleenmäki and Ikäheimo 2013).

discussion and analysis of the relationship between financial accounting and management control. However, we would like to stress that these research areas are vast and that our ambition has not been to cover them in any detail.

To sum up: The tentative analysis and conclusions are to a large extent based on the findings in the articles identified in the literature review as well as our own knowledge and experience in the area. The empirical data that we used is limited in nature. Therefore, as mentioned, the authors of this book have initiated a research project with a research design that is a comparative case study, where financial accounting and management control in two banks are studied over a period of 15 years (2000–2015), to further develop our framework and refine the analysis and conclusions drawn in this book.

1.9 The Organization of the Book

In Chap. 2 we further deepen the description and analysis of the tensions and conflicts between uniformity and uniqueness. The first sections in the chapter provide an overview of earlier studies and frameworks. After that we present our theoretical framework. The starting point is that the management control system is uniquely designed and used to meet the needs of a specific company. Against this, the external demands for financial accounting is discussed, an information system that is mainly about attaining comparability in order for owners and funders to make informed decisions, but where the uniqueness of the company must also be grasped in order for it not to lose relevance. The chapter concludes with a discussion of the tensions and conflicts between uniformity and uniqueness.

Chapter 3 provides illustrations of the tensions and conflicts, using examples of concrete accounting standards and the reasoning behind them from the perspective of standard setters. It has long been known that there are several factors that contribute to the large discrepancy between formal and material harmonization (or in other words between harmonization of standards versus harmonization of practices). We discuss how this discrepancy can be understood as a result of the tensions and conflicts between demands for uniformity and uniqueness. We trace these tensions and conflicts with the help of specific examples. The examples are illustrations of issues that are raised within the areas of segment reporting, goodwill accounting, business combinations and financial instruments.

Chapter 4 is an extended analysis of the discussion in Chap. 3 using our theoretical framework. By reasoning based on our knowledge and experience in the area, as well as results from our literature review, the analysis focuses on the possible effects of financial accounting standards on management control. We base our analysis on the classical division of management control in strategic planning, budgeting, follow-up and analysis and finally rewards and compensation. How these different categories of the management control process are affected by financial accounting is discussed by using the examples in Chap. 3 (i.e. segment reporting, goodwill accounting, business combinations and financial instruments).

In Chap. 5 we discuss the challenges that a company faces in relation to its stakeholders as tensions and conflicts between the objectives of different information systems. Trends towards integration of information systems are discussed as well as challenges for both senior executives and standard setters in dealing with the complexity of transparency. We also briefly touch upon whether, it is possible or even desirable to resolve the identified tensions and conflicts between financial accounting and management control. Finally we summarize important implications and offer recommendations for future research.

Chapter 2
Theoretical Foundations

2.1 Introduction

The first chapter introduced fundamental concepts and relationships. We discussed financial accounting and management control, the two most important information systems of any organization, and their objectives and interrelationships. It was concluded that even though these information systems have many similarities they are also different, designed to fulfil the needs of stakeholders with quite different demands. Owners and funders demand uniform financial reports in order to increase transparency and be able to compare the results of similar investments. The board, senior executives and employees demand unique controls that are designed to fit the very specific strategy of the company. Since these basic requirements are different, it can be expected that there will be tensions, even conflicts, between financial accounting and management control systems.

In this chapter we will elaborate on the description and analysis of the conflict between uniformity and uniqueness by presenting a theoretical framework that will be used throughout the book. The first two sections will provide the reader with a short overview of important earlier studies of the relationship as well as possible tensions and conflicts between financial accounting and management control systems. The third section introduces some earlier models and frameworks that can be used to describe and analyse the tensions and conflicts. After that our framework will be presented and related to previous studies. In the following sections we discuss and problematize demands for uniformity and uniqueness, as well as the possible tensions and conflicts. The chapter ends with conclusions and implications.

© Springer International Publishing Switzerland 2015
F. Nilsson, A.-K. Stockenstrand, *Financial Accounting and Management Control*,
Contributions to Management Science, DOI 10.1007/978-3-319-13782-7_2

2.2 The "Relevance Lost" Debate

The discussion of the relationship and possible tensions and conflicts between financial accounting and management control is not new (cf. Zeff 2008). In the first chapter we mentioned a few early studies, such as Clark (1923) (cited in Joseph et al. 1996). However, it was not until Johnson and Kaplan published the book *Relevance Lost* that the consequences and seriousness of the tensions and conflicts were observed and discussed in a large community of scholars and practitioners (ibid. 1987). Until then the tensions and conflicts had been acknowledged, but few seemed to take it seriously and very few were really bothered. Perhaps the simple reason was that until the publication of *Relevance Lost* the effects of the tensions and conflicts had not been discussed in a way that really caught the attention of scholars and practitioners (cf. Noreen 1987; Ezzamel et al. 1990).

Especially the title of the book caught the attention and created a sense of urgency, even amongst senior executives only remotely interested in accounting: were the control systems used for the daily running of their companies irrelevant? Even worse—Johnson and Kaplan claimed that the lost relevance of management accounting was one explanation why American companies were not as competitive as they used to be. Their argument was similar to what Hayes and Abernathy (1980) put forward in their seminal article "Managing our way to economic decline". By focusing too much on short-term performance metrics and financial results reported to owners (and other stakeholders outside the company) the company lost out in terms of strategic and long-term development. Too little attention was directed to the challenging task of designing and using a control system that would help managers and employees make decisions that would improve the running of the business and ultimately create a competitive edge as well as value for all stakeholders (including the owners). Kaplan expressed some of these concerns as early as 1984 in an article that could almost be considered a short version of the book *Relevance Lost* (Kaplan 1984, p. 410):

> The profit center concept has seemingly become distorted into treating each division as a mini-company, attempting to allocate all corporate expense, common and traceable, to divisions ... Firms use accounting conventions for internal planning and control, not because they support the corporate strategy, but because they have been chosen via an external political process by regulators at the FASB and the Securities and Exchange Commission (SEC). With management accounting practices now driven by an external reporting mentality, we can start to understand why there has been so little innovation recently in management accounting thought and practice.[1]

In the article Kaplan also gives several examples of how FASB (The Financial Accounting Standards Board) accounting standards affect management accounting.

[1] Kaplan (1984) ends his argumentation by citing Davidson who argued as early as 1963 that "the internal information needs for managing the organization not be made subservient to the external reporting system".

One example is how research and development costs are treated. If they are expensed in the financial account they will also be expensed in the management accounting system instead of amortized over their useful life. Another example is that some companies, influenced by demands from regulators such as FASB, use the same capital charge as in the financial accounts (i.e. the company’s actual interest costs) when evaluating corporate divisions. According to Kaplan this is wrong, since it usually underestimates the true capital cost (i.e. a risk-adjusted capital cost) and hence influences long-term decisions in the wrong way.

Kaplan’s critique was further elaborated in the book *Relevance Lost*, together with Johnson, with many more examples of how financial accounting standards can distort management accounting. As we have already stressed the critique was devastating for the field of financial and management accounting. Both practitioners and scholars were implicitly and explicitly criticized for not trying to stop a development that threatened the sound development of companies, the capital market and the nation state. Even though the critique could be seen as exaggerated most practitioners and scholars found that it was not easy to dismiss. In any case, it was worthy of further study.

Hopper et al. (1992) conducted one of the first studies designed to test the claim of Johnson and Kaplan (1987) that financial accounting affects and distorts management accounting. It was a pilot study of six UK-based companies that interviewed financial and management accountants (three interviews in three companies, two interviews in two companies and one interview in one company). Surprisingly the study found no support for the claim by Johnson and Kaplan (ibid.). The accountants interviewed also believed that senior managers were mainly interested in the financial accounting reports since they were the focus of outside stakeholders. Even though financial accounting did not seem to influence management accounting, it was the former type of information that was primarily used for internal reporting to senior executives. In other words, financial accounting and management accounting seemed to be detached and used in quite different ways. The interviewees also seemed to be satisfied with the design and use of the two information systems. The results by Hopper et al. (1992) are interesting, but it should also be noted that it was an explorative study with few cases and interviews.

A couple of years later Joseph et al. (1996) conducted a survey with the aim of examining the links between financial accounting and management accounting in UK industrial and commercial firms. As discussed in the first chapter this study also came to the conclusion that financial accounting did not seem to influence management accounting to any great extent. At the same time the results could be interpreted in quite the opposite direction: the authors argue that the two information systems could also be so tightly interrelated that the senior executives do not even reflect upon how they are linked and in what way. It is also interesting that another study of 303 UK manufacturing organizations by Drury and Tayles (1997, p. 272) concluded “that Johnson and Kaplan’s claim that financial accounting dominates management accounting cannot be rejected and there is a need for further research”. On the other hand, they also concluded that there could be several explanations for the many similarities between financial accounting and

management accounting information and that these similarities do not automatically imply that the former dominates the latter.

The first explanation, by Drury and Tayles (ibid.), of why external and internal reporting practices seem to converge is that the benefits of investing in two separate systems are not sufficient to justify the cost. The second explanation is very closely related to the first one. Perhaps the companies do not believe that investing in more sophisticated systems will improve decision-making (i.e. in this particular case improved and more accurate product costs). The third explanation is that senior managers would like external and internal reporting systems to be congruent. Since there is evidence that financial reports affect how outside stakeholders evaluate companies, a great deal could be gained by using the same logic for internal performance appraisal. By using the same measures senior executives will focus on enhancing results that will be appreciated by owners and other stakeholders on the capital market.

In addition to these explanations Dugdale and Jones (2003), who study the UK debate (or in their own words "'battles' in the costing 'war'") between advocates of absorption and marginal costing during the period 1950–1975, have identified two other reasons why external and internal reporting practices seem to converge. First they argue that external authorities are proposing solutions that could be regarded as "best practice" and that senior executives are likely to follow such practices. Second, if the two information systems are congruent it should be easier to convince the auditors of the validity and reliability of the accounting numbers used in financial reports. The other two explanations identified, and similar to the ones identified by Drury and Tayles (1997), were the additional cost of running two systems and that differences between performance reported to external and internal stakeholders could be confusing. However, even though there are many reasons why financial accounting can have an influence on management accounting, the authors found limited evidence for the claims of Johnson and Kaplan (1987).

Finally, even though Johnson and Kaplan (ibid.) argued convincingly for how financial accounting affects management accounting, we can conclude from our brief overview that the results from several follow-up studies in Europe present somewhat mixed conclusions. One reason for this is probably that companies in Europe were not exposed to the same demands from the capital market as in the US. Therefore it is reasonable to assume that financial accounting measures had not "invaded" control systems of European companies to the same extent as had been observed in American companies by Johnson and Kaplan (ibid.). It is also important to be aware of the different accounting regimes that existed in Europe during this period and how they had developed to what they were at that point in time. Such an overview, introduced in the first chapter, can be found in Ikäheimo and Taipaleenmäki (2010). They discuss five different eras (craftwork –1820s, mechanization 1830s–1920s, mature mechanization 1930s–1940s, late mechanization 1950s–1980s and finally digitalization 1990s–) (please note that the timeline presented is for the US, which deviates from the timelines for Germany and Finland). The countries were chosen because they have different legal frameworks and also because they have strong traditions in accounting.

As mentioned, Ikäheimo and Taipaleenmäki (ibid.) showed that the convergence and divergence of financial accounting and management accounting differ between the US, Germany and Finland due to institutional circumstances such as tax laws and laws protecting lenders but also due to the level of innovation in management accounting. Another interesting result already mentioned is that in the US convergence tendencies, observed by Johnson and Kaplan (1987), started to make external and internal performance measures congruent as early as the 1930s. In Germany and Finland financial accounting and management accounting were separated since the latter was considered to be better for making management decisions. Based on these three examples the authors are able to show that convergence and divergence of accounting information systems are dynamic and long-term processes in which a state of convergence can lead to divergence and vice versa. In other words, comparison of results from studies based in different countries should always be undertaken with some caution, since the context that influences the design and use of accounting systems can be very different.

2.3 Introducing a New Financial Accounting Regime in the EU

The "Relevance Lost" debate resulted in a great deal of effort being expended on developing management control systems that would be designed and used for strategy formulation and implementation rather than being highly influenced by outside demands for uniformity and comparability. These development efforts were highly visible during the 1990s, leading to such management innovations as Activity Based Costing (Cooper and Kaplan 1997) and the Balanced Scorecard (Kaplan and Norton 1992). For almost 20 years the attention of the management control community was focused on these types of innovations and their effects. Practitioners and scholars seemed to take management control systems that were unique and tailored to the specific situation of the company for granted, and few seemed to bother about the interrelationship between financial accounting and management control. However, the introduction in 2005 of one of the most influential changes in financial accounting ever—the implementation of IFRS in the EU for quoted companies[2]—changed that attitude.

According to Jermakowicz and Gornik-Tomaszewski (2006) the introduction of IFRS was considered to be of instrumental importance to the creation of a single European capital market. The main arguments for introducing IFRS, summarized

[2] For an introduction to some implementation effects of the introduction of IFRS in Europe, see Schipper (2005). One of her conclusions is that effective enforcement of IFRS will contribute to a faster convergence process for financial reporting standards in Europe. Hellman (2011) studying the implementation of IFRS in Sweden draws a similar conclusion stating that "with weak enforcement of IFRS, the change in standards will not lead to the same implementation across firms in accounting practice" (ibid., p. 81).

by the authors and referring to Choi and Meek (2005), were that harmonization of financial statements increases comparability, the level of transparency and the quality of financial information. As a consequence the capital market will become more efficient (i.e. lower costs for preparing financial reports, more efficient investment decisions as well as lower cost of capital). The authors also identified some possible disadvantages, such as the differences between countries and their accounting regimes, and the potential high costs of eliminating these differences. They nevertheless took the position that accounting harmonization is irrevocable and the most interesting question is therefore "to examine the process of implementing IFRS by European publicly traded companies, including the approach which these companies take to conversion, the impact of adopting IFRS on the financial statements, and the perceived benefits and challenges of implementing IFRS" (ibid., p. 173).

The study by Jermakowicz and Gornik-Tomaszewski (ibid.), based on a questionnaire, was conducted during 2004 and included responses from 112 companies (response rate 27 %) in eight countries (11 companies did not state their country of origin). The top three countries in regard to number of respondents were: Germany (46 respondents), Belgium (22 respondents) and France (16 respondents). The study included both early (pre-2004) adopters and so-called first-time adopters. The results show that the foremost benefits were better comparability, increased transparency and harmonization of external and internal reports. The foremost expected costs were tied-up resources, high costs of transition/increased volatility of earnings and balance sheet items (these two expected costs received the same mean score), and that information systems require enhancements to support the IFRS implementation. One especially interesting result is that a majority of the companies had a goal of using IFRS as the means for integrating external and internal reporting. The authors conclude (ibid., p. 190):

> A large percent of our respondents indicated that IFRS-based financial statements have been or will be used not only for external reporting but also for internal decision-making and performance measurement processes in the parent and subsidiaries. This approach to adopting IFRS may prompt an integration of financial accounting and management accounting practice in European companies or even lead to an external reporting/financial accounting domination of internal reporting/management accounting as noted by Johnson and Kaplan (1987).

Another study of the introduction of IFRS was conducted by Jones and Luther (2005). This explorative study included three German manufacturing companies (four interviews in each company) and two management consultancy firms (one interview in each firm). Like Ikäheimo and Taipaleenmäki (2010), they discuss the very strong German tradition, dating back to the legendary and influential scholar Eugene Schmalenbach, who was active in the early twentieth century, of separating financial accounting and management control. As mentioned earlier in Germany the protection of lenders is of paramount interest and the financial accounts will therefore not be very suitable for making management decisions. The introduction of IFRS seems to have changed this view, at least in the companies included in the study. The reasons for this change in attitude is not clear, even though it seems like

IFRS is considered to be more relevant for internal decision-making compared to an external report based on historical cost accounting. The authors also speculate whether the switch to a new accounting regime made companies reconsider the benefits of integrating external and internal reporting:

> For a number of reasons then, January 2005, may be regarded as a potential turning point in the development of German manufacturing management. One possibility is that Germany, with new confidence in the credibility of the imported systems, will develop in a similar fashion to the USA and UK in the 1980s in its reliance on financial accounting information. (ibid., p. 184)

In the later part of the article the authors express some worries regarding this development and the consequences it could have for German manufacturing companies. These companies, and their success, have always been closely related to a management control system that is to a large extent based on detailed manufacturing information. They conclude (ibid., p. 186):

> There would be a strong element of irony if German manufacturing companies' adoption of IFRS were to lead to internal reporting/management accounting becoming dominated by external reporting/financial accounting since it was precisely this that Johnson and Kaplan (1987) held responsible for the decline of US manufacturing companies in relation to their international competitors—including Germany. It would also be at odds with the trend in the USA and UK for greater, rather than less, distance between financial accounting and management accounting incorporating activity-based costing, balanced scorecard and other leading, non-financial performance measures.

Ewert and Wagenhofer (2007) present a view similar to that of Jones and Luther (2005) regarding the possible future increased convergence of financial accounting and management accounting in German companies. However, their conclusions of the possible effects of such a development are more positive and optimistic. The reason is that they consider international accounting standards, such as IFRS, to be more relevant for management decision-making than German financial accounting rules. According to Ewert and Wagenhofer (ibid.) international accounting standards are less conservative when it comes to income recognition and measurement issues. They are also more geared towards the internal management of the company, which is evident in the importance attached to such areas as risk management and segment reporting. A stronger capital market orientation of German companies is also visible in the increased use of value-based management techniques. They are based on a belief that there is a strong congruence of the goals between the owner and the senior executives and therefore they should ground their decisions on the same type of information. In addition the authors suggest that new accounting standards could trigger the company to acquire new accounting data, possibly helping to improve the management control systems. The authors also identify many other benefits and costs (see Table 4, p. 1041 for a summary). Most of these we have already discussed in our account of other similar studies.

Building on the results showing an increased convergence of financial and management accounting in German companies, Weißenberger and Angelkort (2011) launched a survey to study whether integration of these two information systems has a positive impact on controllership effectiveness. Their overall

theoretical starting point, building on Joseph et al. (1996), is that such integration "does not necessarily have detrimental effects on managerial decision-making and control" (Weißenberger and Angelkort 2011, p. 163). A questionnaire was sent both to the controller and manager in 1,269 German companies, resulting in 149 dyadic sets of responses (a response rate of 11.7 %). The results show that "integration of accounting systems" is a complex phenomenon and is far from the only factor influencing "consistency of financial language". The authors conclude that numbers from the financial accounting system cannot be used in a naïve fashion, that is, merely assuming that they are relevant for internal decision-making. In planning and budgeting as well as performance measurement integration of financial accounting and management control did not seem to be very important. What seemed to be more important was that the information was useful and relevant for control purposes.

The final study in this brief overview confirms many of the results from earlier studies. Using institutional theory Brandau et al. (2013) has investigated drivers of management accounting conformity in Brazilian and German companies. Semi-structured interviews were conducted in ten Brazilian and ten German manufacturing companies. The study shows that the management accounting systems are affected by outside forces such as implementation of IFRS, consulting firms introducing management accounting innovations and the internationalization of university education. The authors conclude that their study does not give support to contingency theoretical assumptions, since the convergence of management accounting techniques in the companies studied is high despite the fact that the contexts of Brazilian and German companies are quite different. Instead they argue that the institutional forces identified are the drivers of conformity.

Finally we can conclude that the number of studies that have investigated the integration of financial accounting and management control is rather limited, even though we do not claim that our review is exhaustive. Based on the studies that we have reviewed, we can nevertheless draw the conclusion that the introduction of IFRS seems to have contributed to a debate quite different from the so-called "Relevance Lost" debate. With some exceptions the studies show that IFRS could possibly provide more relevant information for management decision-making than historical cost accounting. There are also some indications that the IFRS accounting regime was considered to be an important event that changed the fundamentals of financial accounting. Therefore it was also appropriate to reconsider the relationship, and possible integration, of financial accounting and management control. Another important development, observed by Taipaleenmäki and Ikäheimo (2013), among others, is the introduction of new information technology solutions (e.g. enterprise resource planning systems and business intelligence solutions) which offer new possibilities for information system integration. It should be stressed, however, that it is well known in the literature that information system integration is a difficult endeavour with no guarantees of success (see for example, Teittinen et al. 2013). Overall there seems to be a more nuanced debate about the relationships and possible tensions and conflicts between financial accounting and

management control after the introduction of IFRS compared to the "Relevance Lost" debate.

2.4 Models and Frameworks for Analysing and Managing Relationships Between Accounting Systems

As a result of the increased interest for analysing and managing the relationship between different accounting systems—and especially how to integrate accounting information—several models and frameworks has been developed. Some of them are presented below.

2.4.1 The Performance Pyramid

McNair et al. (1990) presented a model that could be used to analyse the important and fundamental question of whether financial and non-financial measures have to agree. At the most fundamental level this question has to do with how financial measures—which are used for external reporting (i.e. financial accounting)—are related to non-financial measures used for internal control purposes (i.e. management control). The authors do not provide a simple answer to that question but instead discuss in what way financial and non-financial information can be used together to better understand how the company is performing and to guide future decision-making.

Their model, is based on a hierarchical view of the company starting with the overall vision and objective that is cascaded down to the business units and their departments (functions). At the lowest level the information used is primarily non-financial in character, since that type of information is easy to understand and relate to specific operational tasks. At the highest level the information is primarily financial in character. That type of information is suitable for evaluating value creation for the owners by comparing it with other similar companies through the standardized format of a financial report.

It is well known that non-financial and financial information cannot be aggregated, and it is therefore difficult to create a fully integrated accounting system. On the other hand, that is not necessarily a problem. According to the authors it could almost be seen as an advantage. Their opinion is that non-financial information should be translated into financial information and vice versa. This translation process has the advantage of contributing to discussing, and hopefully enhancing the understanding of how value is created in the company through improving operational activities. Since the format of non-financial and financial information is very different, senior executives and employees must discuss in depth how they are related and can also be a help to gain new insights in the analysis of performance

at different organizational levels (i.e. corporate, business unit and functional levels). If the company were able to create a process in which these types of discussions are well established, it would be reasonable to talk about an integrated control system. Jannesson et al. (2014, p. 2) define such a system in the following way: "A firm with an integrated control system has created a consistent flow of information within and between the central instruments of control." The model of McNair et al. (ibid.) is designed to show how such a "consistent flow of information" can be accomplished.

2.4.2 The Balanced Scorecard

The Balanced Scorecard is probably one of the best-known management control models that exist today. The model is described in several books by their inventors (for example, Kaplan and Norton 1996, 2001, 2004) as well as other researchers and consultants (for example Olve et al. 1997, 2003). It should be noted that there are other models similar to the Balanced Scorecard, for example the Performance Pyramid. In this overview we have chosen not to include all models and frameworks but instead focus on the ones in which the relationships between financial accounting and management control seem to have influenced the author(s) or are at least implicitly acknowledged in their articles and/or books.

The Balanced Scorecard could be seen as an answer to some of the criticism in the "Relevance Lost" debate, since it focuses on creating a stronger relationship between the strategy of the company and the design and use of the control system. The authors stress the importance of creating a control system that is designed to fit the unique situation of a company, making it relevant to strategic, tactical and operational decision-making. Starting with strategy, the company should identify the key performance indicators (KPIs) of that strategy and sort the KPIs into four perspectives mirroring the most important aspects of the business (the financial perspective, the customer perspective, the internal process perspective and the learning and growth perspective). In the next step the KPIs are used to identify suitable financial and non-financial performance measures. These measures are instrumental in tracking how the company succeeds in implementing the strategy as well as formulating new strategies.

Like the Performance Pyramid model, the Balanced Scorecard is built on a logic in which financial and non-financial information is connected and interrelated. In the early versions of the model, this connection was not very explicit. More than a decade later than the first model was introduced Kaplan and Norton published *Strategy Maps*, which took the Balanced Scorecard to the next level of development (ibid. 2004). In a Strategy Map the causal relationships between the different KPIs are highlighted illustrating how these indicators contribute to implementing the strategy and ultimately creating value for the owners and other important stakeholders. Since each KPI will have at least one performance measure linked to it, a Strategy Map is also a guide for how to connect non-financial and financial

measures. In that sense the Balanced Scorecard and the Strategy Map represent a development of the ideas first presented by McNair et al. in the 1990s.

By combining maps from all units within a corporation it is possible to show how operational activities contribute to the profit (or loss) that is found in the external financial reports. Balanced Scorecards and Strategy Maps have also been used for the analysis of changes in the balance sheet and especially the development of intangible assets that are not included in the statutory report, or, in the words of Edvinsson and Malone (1997), so-called "intellectual capital". Even though the Balanced Scorecard and the Strategy Map were introduced with the ambition of at least partly integrating accounting information—both from financial accounting and management control—the merit of the model is above all the fact that it makes strategy the focus of control system design and use.

2.4.3 Activity-Based Costing

The difficulties of integrating accounting information are also evident when different cost systems are compared and the pros and cons of their possible integration are discussed. One of the conclusions from the "Relevance Lost" debate was that financial accounting standards can distort the calculation of product costs and inventory valuation. Therefore Kaplan and Cooper introduced a new framework for product cost calculation known as Activity-Based Costing (ABC). In an ABC system the cost of resources is "based on standard activity cost driver rates and practical capacity of organizational resources" (Cooper and Kaplan 1998, p. 111). In a traditional system the cost is defined as the expenses that can be found in the ledger of the financial accounting system (a detailed presentation of ABC is provided in Cooper and Kaplan 1997). The authors clearly point out the difficulty of integrating these two *internal* control systems in the following quote (Cooper and Kaplan 1998, p. 110):

> Managers must realize that operational-control and activity-based cost systems have fundamentally different purposes and are separate for good reasons. The first system provides information about processes and business-unit efficiencies. The other provides strategic cost information about the underlying economics of the business. Managers must be aware that the two managerial cost systems are so different—in their requirements for accuracy, timeliness, and aggregation—that no single approach can possibly be adequate for both purposes.

Kaplan and Cooper stress that both traditional cost systems as well as ABC systems have been developed mainly for internal decision-making and not to satisfy the needs of external reporting (i.e. the financial accounting system). The authors argue that financial accounting is designed to satisfy the needs of different external stakeholders such as the owners, lenders, tax authorities etc. As a consequence the information—in the form of aggregated costs and inventory value—is not very useful for managers trying to understand the drivers of production costs or the inventory value. On the other hand, Kaplan and Cooper also acknowledge the value

of integrating different accounting systems but underline that such integration must be done carefully. The traditional cost system is usually well integrated with the financial accounting system, providing the latter with actual costs for calculating the costs of goods sold and inventory value. The ABC system could be used to calculate standard product costs, but it will usually be necessary to make some adjustments to the values provided so that they are compliant with financial accounting standards. Finally a traditional system and ABC system could be integrated in order to let managers "transform so-called fixed costs into variable ones and to think prospectively, rather than retrospectively, about strategic costs and profitability" (ibid., p. 114). Even though the authors identify some advantages of integrating accounting information, they close the article with a statement that clearly show which information system they think is the more important one (ibid., p. 119):

> Periodically, the integrated managerial systems distribute information to the financial accountants, who then reconcile it for reporting purposes. If the accountants complain about the information they receive, or the difficulty of reconciling it, managers and operators may be tempted to say, "This is the information we use to run the business. Try to learn how to use it to prepare your financial statements."
>
> That shift in emphasis—where an internal understanding of the company's economics is in the foreground and external numbers are important but secondary—marks a significant coming age for managerial accounting.

2.4.4 The Corporate Responsibilities Continuum

Bhimani and Soonawalla (2005) also acknowledge the differences between financial reporting and other accounting information systems such as the management control system. But they also recognize that integration of accounting information has many advantages and is desirable, especially from the perspective of corporate responsibility. To ensure that vital stakeholder interests are not endangered, the information systems must provide transparent and reliable information. The authors seem to believe that standards and codes are vital mechanisms for ensuring that information systems fulfil these and other reasonable quality criteria.

As a basis for their analysis Bhimani and Soonawalla (ibid.) have developed the Corporate Responsibilities Continuum (Fig. 2.1). This framework is based on a continuum with corporate conformance and corporate performance as end-points. Corporate conformance is a vital characteristic of financial accounting. There are

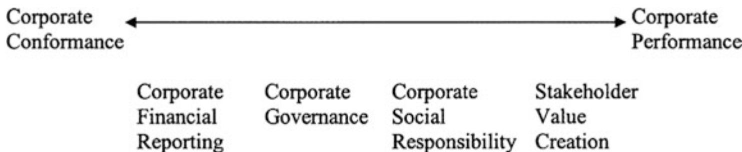

Fig. 2.1 Bhimani and Soonawalla (2005) The corporate responsibilities continuum, p. 168

different oversight mechanisms—such as guidelines, frameworks, auditors and audit committees—that ensure compliance with laws and regulations. Corporate performance is a vital characteristic of management control. Since these systems are usually tailored to the specific situation of the company, it is difficult to develop standards and codes.

The framework identifies four different information systems that are vital for most companies: Corporate Financial Reporting (CFR), Corporate Governance (CG), Corporate Social Responsibility (CSR) and Stakeholder Value Creation (SVC). They discuss each of these systems and their respective oversight mechanisms. A not-too-surprising conclusion is that CFR has the most developed mechanisms (for example GAAP) followed by CG (for example SOX). CSR also has mechanisms to guide enhanced conformance (for example ISO 9000). However, as pointed out by Coupland (2006) in a critical study of CSR reporting in banks, managers have considerable discretion in choosing what type of information to present. That can lead to a situation in which transparency can be compromised and accountability difficult to demand. SVC has so far few well-established mechanisms, even though Bhimani and Soonawalla (ibid.) believe that will change since the pressure to adapt best practices in the broad area of management control will continue to increase. There is for example a CIMA (Chartered Institute of Management Accountants) initiative to introduce so-called strategic scorecards that can help the board to develop and assure that the strategy process is effective.

The authors conclude that conformance and performance are interrelated, since they believe that performance is, at least to some extent, dependent on conformance. The four different information systems—or in the words of the authors (ibid., p. 172) "four elements of corporate responsibility reporting (CFR, CG, CSR and SVC)"—provide different, but at the same time related, reports of what the company has achieved and the resources used in that process. Because of the relatedness of the information provided, the authors believe that these systems could be much more fully integrated. That would contribute to a more comprehensive and inclusive discussion of corporate responsibility and its many different dimensions and perspectives. In contrast to the views of among others Johnson and Kaplan (1987), they are also critical of the notion that the information needs for internal and external stakeholders must be different (Bhimani and Soonawalla, ibid., p. 172):

> The implications of the corporate responsibilities continuum are particularly far reaching in that it suggests that debates that have called for differentiation between financial and management accounting (Johnson and Kaplan, 1987) need to now be qualified. Envisioning corporate performance and conformance as being underpinned by a common link forces a revised conception of the desirability of segregating corporate control from external stakeholder communication responsibilities.

2.4.5 The Integrated Reporting Framework

Bhimani and Soonawalla (2005) are not alone in arguing for integrated information systems. The International Integrated Reporting Council (IIRC) was founded in 2009 and launched its framework in 2013 (IIRC 2013) (www.theiirc.org). The council and its framework have quickly become influential. One of their aims is to (IIRC, 2013, p. 2): "Support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term." According to the framework a company uses many different capitals and consists of many units and functions. The integrated reporting process will result in a report that shows how company capitals (financial, manufactured, intellectual, human, social and relationship, and natural) are affected by organizational activities. The management of the value-creation process is described in the strategy which is an important part of the integrated report. It should include the following according to the framework (IIRC 2013, p. 24):

- Organizational overview and external environment
- Governance
- Business model
- Risks and opportunities
- Strategy and resource allocation
- Performance
- Outlook
- Basis of preparation and presentation and in doing so, takes account of:
- General reporting guidance

The idea is to give a detailed and relevant report that combines financial and non-financial information in a coherent way and in far greater detail than in models such as the Balanced Scorecard. It is reasonable to expect that financial performance will probably reach a rather high level of comparability between companies, while non-financial information will be more difficult to compare. The reason is that the former type of information is already affected by various efforts to reach a high level of uniformity compared to non-financial information, which is mainly used for internal decision-making. However, it should be noted that the framework is not very detailed in the description of how the report should be prepared and what difficulties could be expected. For example it does not explicitly cover financial reporting standards and their possible influence on integrated reporting. The framework is rather a set of recommendations and high-level principles. It should also be noted that there are several similar frameworks for integrated reports. Another example is the so-called "One Report" which is designed for integrated sustainability reporting. In a comment about this later framework Eccles and Krzus (2010) summarizes the essence of integrated reporting at a general level, making it highly relevant for the IIRC framework as well (ibid., p. 29 f):

> One Report does not mean only one report, Yes, by simplest definition, One Report combines a company's key financial and nonfinancial information into a single document. However, the integration of financial and nonfinancial reporting is about much more than simply issuing a paper document. Namely, One Report serves as a means for reporting financial and nonfinancial information in a way that reveals their impact of each other, answering a fundamental question: Just how does nonfinancial performance contribute to financial performance, and vice versa?

2.4.6 The Taipaleenmäki and Ikäheimo Framework

The final and most recent framework in our overview has been developed by Taipaleenmäki and Ikäheimo (2013). This framework can be used for analysing the role of IT and how it affects the convergence of financial accounting and management accounting. The authors' starting point is that there is a tendency to converge these two information systems. They argue that since the introduction of IFRS, financial accounting has become less focused on the traditional stewardship role and much more focused on the decision-making of owners, the information asymmetries between owners (i.e. investors) and senior executives tend to decrease. In line with this reasoning, it would be advantageous to integrate financial and management accounting and by doing so use the same performance measures externally and internally. In that way it would be possible to reach some basic level of goal congruence between owners and senior executives. This development is illustrated in Fig. 2.2 the first section ("function/orientation of accounting") in the framework.

The later sections of the framework discuss the different roles of IT in the convergence of financial and management accounting. According to the authors IT has a huge potential to contribute to integrating these two information systems, and in that process it can act as a facilitator, a catalyst, a motivator and an enabler. The role of IT affects the outcome of the convergence process in two dimensions: technical and behavioural. The first dimension is about systems, software and methods used (focus on data and information). The second dimension is about functions, processes and roles (focus on information and knowledge). Based on these two dimensions, the authors discuss in detail the convergence of financial and management accounting and that the direction could be either one-way (financial accounting affects management accounting or vice versa) or two-way (financial accounting affects and is affected by management accounting). Convergence in the technical dimension is discussed based on structural aspects of accounting, such as accounting standards, performance measures, transfer prices etc. Convergence in the behavioural dimension is discussed based on process aspects of accounting, such as reporting schedules, budget processes but also some overall organizational aspects—for example, control of business networks.

Taipaleenmäki and Ikäheimo (ibid.) argue that convergence of financial accounting and management accounting could be expected to take place first in the technical dimension and then move on to the behavioural dimensions.

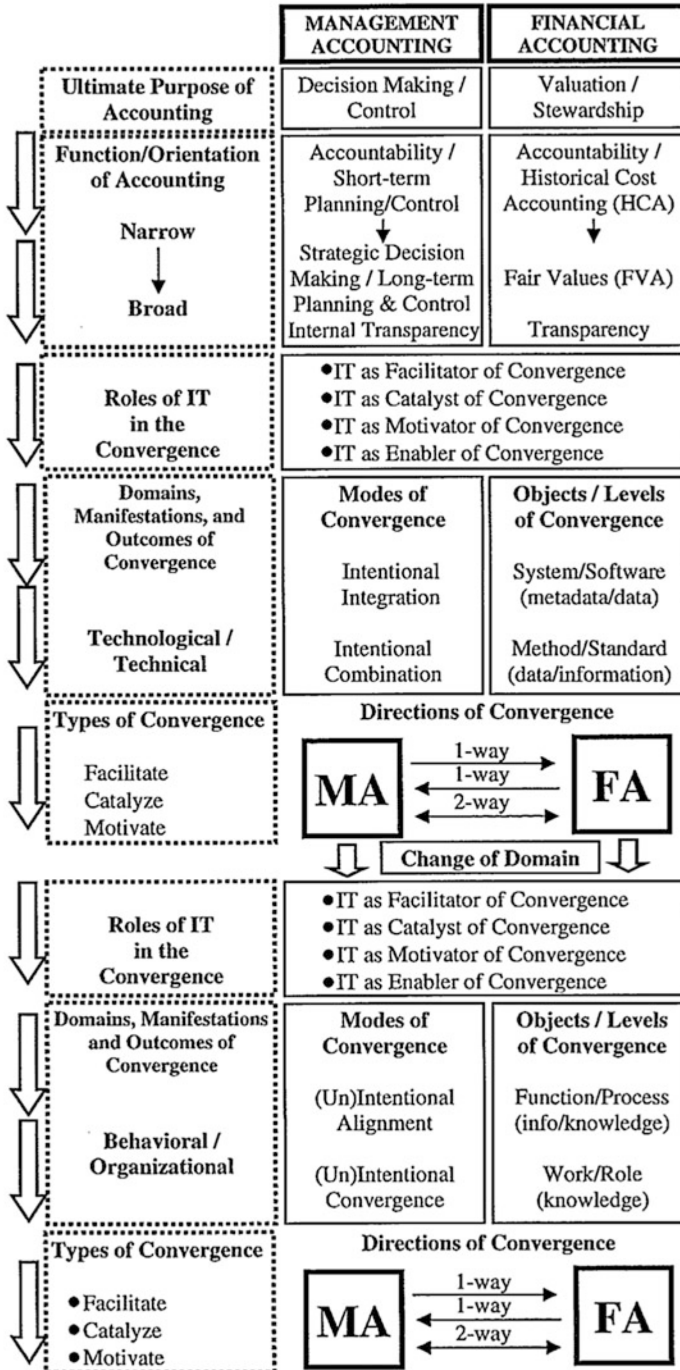

Fig. 2.2 Taipaleenmäki and Ikäheimo (2013) Conceptual framing for analysing convergence of financial accounting and management accounting, p. 10

The authors use several examples to illustrate their reasoning, such as the goodwill impairment test (Statement of Financial Accounting Standard [SFAS] 141 *Business combinations* and IFRS 3 *Business combinations*) and segment reporting (SFAS 131 *Disclosures about segments of an enterprise and related information*, and IFRS 8 *Operating segments*). In the first example management information, which is arguably more forward-looking than financial accounting information, is used to provide input to the calculation of fair value in goodwill. The second example is perhaps the best illustration available in the literature of a situation in which information used for internal purposes is considered to be useful for external evaluation (cf. Chap. 3).

All in all the authors have developed perhaps the most detailed framework so far. The authors draw on an analytical model that was developed by Hemmer and Labro (2008) and uses principal-agent theory. The examples of convergence are developed using "earlier studies as indirect empirical evidence and our experiences from the field" (Taipaleenmäki and Ikäheimo 2013, p. 3) as well as informal discussions with several CFOs, controllers and auditors. Another characteristic of the framework is that the authors see huge potential in an integration of financial accounting and management accounting. They almost seem to believe that the development towards convergence is inevitable and that the benefits clearly outweigh the costs. The reason for their enthusiasm is the promises of new IT solutions, an enthusiasm they share with many other researchers (see for example Rom and Rohde 2007). It should be noted however, that several researchers are more sceptical about the possibilities of creating an integrated accounting system with the help of IT (see for example Dechow et al. 2007).

> As the field of accounting is very broad and the motives behind the areas different, it requires also diversity and flexibility from IT/IS solutions to meet the current demands of accounting. For example, it requires quite different accounting and information technology to produce business relevant managerial information such as segmented customer profitability calculations or financial accounting statements to meet the requirements of law and shareholders, although the basis could be partly the same transaction processing system(s). Typically such outputs require different information input. (ibid., p. 633)

The following quote is a summary of the conclusions by Taipaleenmäki and Ikäheimo (2013, p. 22):

> The ultimate purpose of MA and FA is the same. This includes evaluation of past performance for informative and accountability purposes, and plans for the future to make rational capital allocation decisions. The recent trend shift of MA from history-based short-term planning and control to future-oriented strategic planning and control, and FA from historical cost accounting for stewardship purposes to fair value accounting for valuation purposes and decision making, as well as increased transparency for broader stewardship have planted the seeds for the convergence between MA and FA. Why convergence was not a clear direction earlier can be explained by the previous lack of a key element, i.e. information technology that could facilitate, catalyze, motivate, or even enable the convergence first in the technical and technological domain and later in the behavioral and organizational domain.

The next section of the chapter will present our theoretical framework, building on the earlier works by Nilsson and Stockenstrand (2013). This early version of the

framework has been further developed using results from earlier studies in the field as well as theories that can help us better understand the demand for uniformity and uniqueness as well as the tensions and conflicts between these two drivers. The framework is presented in detail in the following section and its sub-sections.

2.5 Our Theoretical Framework

The previous section described models and frameworks for analysing the relationships between accounting systems (i.e. financial accounting and management accounting/control systems). From this overview it is possible to draw several conclusions. First we can conclude that only a few well-known models and frameworks exist (we do not, however, claim that our overview is exhaustive). Second, all models and frameworks acknowledge that there are tensions and conflicts between the information systems. Third, there are different views on whether and how these tensions and conflicts can be resolved. Fourth, in more recent frameworks new IT-solutions and the introduction of new accounting regimes such as IFRS are used as arguments for an increased level of integration—or at least reasons are given to reconsider the possibilities. Fifth, most of the models and frameworks (the one by Taipaleenmäki and Ikäheimo (2013) is an exception) do not provide a detailed analysis of the origins of the tensions and conflicts between the information systems and how the tensions and conflicts affect these systems.

To sum up, we can conclude that there is a need for a continuation of the important conceptual work already started by scholars to develop a framework that can be used to enhance our understanding of the relationships between financial accounting and management control (accounting) and the possible tensions and conflicts between these two information systems. Figure 2.3 presents a modified version of the original framework by Nilsson and Stockenstrand (2013). This framework is intended as a contribution to the stream of literature presented and discussed in the book. However, the framework, as visualized in Fig. 2.3, is rather general[3] and the driving forces affecting financial accounting (i.e. demands for uniformity) and management control (i.e. demands for uniqueness) are well known in the literature. Therefore the main contribution is not the figure as such but rather our analysis of the demands for uniformity and uniqueness and how they can be explained and understood, especially how they interact and affect one another creating tensions and even conflicts between the two information systems. The framework is primarily used to position and structure our explorative and tentative

[3] For example, Törnqvist (1999, p. 143) has presented a figure that illustrates the relationship between financial accounting and management accounting when studying accountability. However, this figure—similar to other frameworks and models—does not show what affects the design and use of the two information systems. Nor are the causal relationships between the information systems shown.

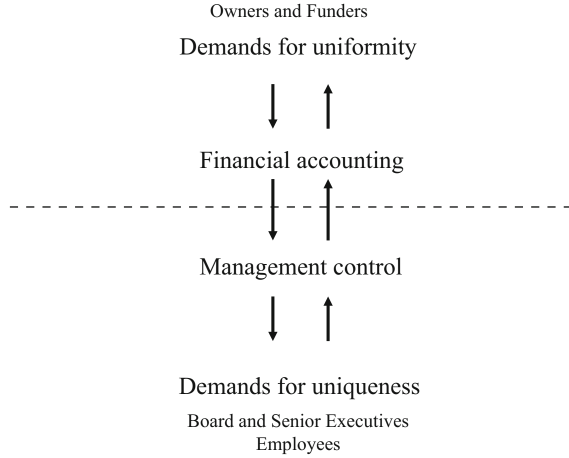

Fig. 2.3 Our theoretical framework (cf. Nilsson and Stockenstrand 2013, p. 3)

analysis of the complex relationship between financial accounting and management control.

Starting at the top of the Fig. 2.3 and in line with our reasoning so far, demands for uniformity are driven by several factors. The most important one is the quest for accountability, or in other words that the board and senior executives (the "agents") are accountable to the owners and funders (the "principals"). There are also principal-agent relationships within the company, for example between corporate management and divisional/business unit managers as well as between managers and employees (cf. Eierle and Schultze 2013). For reasons of simplification we do not consider employees agents in the following discussion.

In order to be able to hold the board and senior executives accountable for their decisions and actions, the owners and funders will strive to reduce the information asymmetries that exist between principal and agent. Through the financial accounting system the information asymmetries can be reduced and transparency increased (cf. Jensen and Meckling 1976). But even though transparency is very important, it is not sufficient to evaluate organizational performance and hold agents accountable. Performance must also be compared to something in order for it to be evaluated and to decide whether the agents should be rewarded or not. Therefore the financial reports must be designed in a uniform way in order to make them comparable (e.g. Brandau et al. 2013).

If the demand for uniformity affects the design and use of financial accounting, the opposite of uniformity—i.e. uniqueness—affects the design and use of management control. Since the primary objective of a management control system is to formulate and implement strategies (Simons 1995), and the company strategy must be unique for a company to be competitive (Porter 1996), the control system must also be unique (Jannesson et al. 2014).

Because demands for uniformity are closely connected to the quest for accountability, senior executives will also hold their managers accountable, sometimes by mirroring the same performance evaluation techniques as those used by external stakeholders, such as owners and funders. This can create a tension, or even conflict, between the two information systems. At the same time the introduction of a more principles-based financial accounting regime (i.e. IFRS) can give the company some leeway in adapting the financial reports to what they would like to present to the outside—for example through segment reports. New IT solutions can also help to resolve some of the tensions and conflicts presented in earlier literature (cf. Taipaleenmäki and Ikäheimo 2013).

The following sub-sections will further discuss the possible tensions and conflicts as well as the demands for uniqueness and uniformity. We will start by discussing demands for uniqueness, since we would like to stress the organizational focus when we later on problematize tensions and conflicts. Uniqueness is also strongly connected to value creation and competitiveness. As discussed in Chap. 1, a company must design and use the management control system in such a way that it will contribute to the successful formulation and implementation of a competitive strategy. We also stressed that since the strategy is unique, the management control system must also be unique. Financial accounting is used to evaluate value creation and whether the strategy chosen is successful, or in other words if the company is competitive on the capital and product markets. With this logic as a starting point we have elected to start with discussing management control and demands for uniqueness. We will then move on to discuss demands for uniformity and how that demand emanates from a need to have comparable accounting information in order for owners and other stakeholders to evaluate competitiveness and ultimately value creation. Finally the tensions and conflicts between uniqueness and uniformity will be discussed. We will show that the evaluation of value creation (the objective of financial accounting) does not necessarily lead to the same information needs as when value is created (the objective of management control). This paradox—that a focus on value creation does not automatically lead to a situation in which financial accounting and management control converge—is not acknowledged by standard setters (cf. Eierle and Schultze 2013).

2.5.1 Demands for Uniqueness

Probably one of the most robust and well-grounded results in the broad field of accounting is that management control systems should be designed and used in line with the unique situation of the company. Today this seems to be a reasonable and not especially surprising conclusion. But in the 1970s and 1980s it was as hot research topic in the accounting field. Before that there was not much interest in studying variations, and their causes, in management control system design and use. Scholars and practitioners alike seemed to believe in a more universal design and use of management control systems. Some influential studies in the organizational

field of research changed that (Burns and Stalker 1961; Lawrence and Lorsch 1967; Thompson 1967). These studies showed that the company is an open system in which the environment affects how it is organized. For example, a flexible organization (e.g. decentralized decision-making, informal hierarchy) is suitable in a turbulent environment and a mechanistic organization (e.g. centralized decision-making, formal hierarchy) is suitable in a stable environment (Burns and Stalker 1961). These pioneering studies lay the foundation for the so-called contingency theory. This theory inspired many accounting researchers to study how variations in contextual factors affect management control systems. Miller and Power (2013), in their overview of the accounting field, conclude that contingency theory became very influential in one main stream of accounting research: behavioural accounting.

During the 1970s and 1980s research efforts were directed towards finding the most important contextual variables and how alignment with them affects organizational performance. Environmental uncertainty proved to be very important, but other contingency factors were also identified, such as technology and the size of the organization. The results were a bit ambiguous, however, and not always easy to interpret. Therefore any hope of being able to explain how management control systems are affected by contextual variables started to evaporate (Otley 1980; Chapman 1997). However, in the early 1990s, probably affected by conclusions drawn as a result of the "Relevance Lost" debate, the strategy of the company received considerable attention in discussions of the design and use of management control systems. In 1991 Eccles wrote an article in *Harvard Business Review* arguing for aligning performance measures to company strategy (Eccles 1991). As mentioned in a previous section, the 1990s also saw the introduction of frameworks and models based on the idea that the prime objective of management control is to formulate and implement strategies (e.g. the Balanced Scorecard). Contingency researchers, for example Archer and Otley (1991), saw the potential of strategy as encompassing most of the variables already identified (e.g. environment, technology and size). Strategy was the link between the environment and the company.

It is interesting that strategy once again became the limelight of management control thinking. As early as 1965 Robert Anthony, in his influential framework, defined management control as "the process by which managers assure that resources are obtained and used effectively and efficiently in the accomplishment of the organization's objectives" (ibid., p. 27). Even though Anthony was among the first to acknowledge the importance of strategy in management control design and use, he was not very specific regarding what the relationship really looked like (cf. Zeff 2008). He emphasized that the link between strategic planning, budgeting and performance evaluation was of fundamental importance. But it was not until researchers identified strategy as an important contingency variable that the relationship identified by Anthony could be further developed. In late editions of his framework, some of these new research insights are presented (see for example Anthony and Govindarajan 2007). The relationships between strategy and management control are also presented in many other journal articles and books (see for example, Nilsson and Rapp 2005; Jannesson et al. 2014). Since these relationships

are well known in the literature, we will not repeat them here. We will, however, mention some of them in more detail later on in the book. Those interested in learning more about these relationships are recommended to read the publications mentioned. They will provide the reader with a thorough and detailed discussion of the empirical studies that have investigated the relationship between strategy and management control.

To the disappointment of many researchers, the initial high expectations that strategy would take contingency theory to a new and higher level of understanding of what affects management control was not entirely met. Large-scale surveys resulted once again in ambiguous and even contradictory results. As discussed in Nilsson and Stockenstrand (2014) some researchers claim that the reasons for that were weak theoretical underpinnings and use of inappropriate statistical methods (see for example Gerdin and Greve 2004, 2008). Other researchers argue that the strategic typologies are used and compared incorrectly and that more attention should be given to the operationalization of the strategy construct (Kald et al. 2000). A more radical position is presented by researchers questioning whether surveys could capture the very complex relationships between strategy and management control design and use (see for example, Nilsson and Rapp 2005).

Following that line of argument, Nilsson and Rapp (2005) developed the framework in Fig. 2.4 and proposed that it should be tested and further developed by conducting deep and longitudinal multi-level case studies. The framework was developed following three overall conclusions by Nilsson and Rapp (2005). First, large companies have different strategies for different organizational levels (e.g. the corporate, business and functional levels) and these strategies should be aligned, creating a high level of strategic congruence. Second, the control systems of a company (e.g. management control and production control) should form a coherent, integrated planning and follow-up system. Third, companies that have reached a high level of strategic congruence and integrated control will operate at a higher level of efficiency and be more competitive than companies with incongruent strategies and disparate control systems. These hypothetical relationships between strategy, control, competitive advantage and performance are shown in Fig. 2.4.

Almost 10 years after the framework was presented by Nilsson and Rapp (2005), Jannesson et al. (2014) published an edited volume of research that contributes to developing the framework in general and enhancing our understanding of the relationship between strategy and control systems. The results from eight case studies of competitive companies and organizations show that strategic congruence and integrated control are important theoretical concepts. They also show the strength of conducting case studies to further develop contingency theory and how the demand for uniqueness can be understood in concrete implications for the design and use of management control systems (as well as production control).

Finally a comment about why we have chosen to use the term management control in the framework of this book (cf. Fig. 2.3). Many of the studies of the tension between financial accounting and control use the term management accounting instead. The reason is probably that Johnson and Kaplan (1987) focused on management accounting and discussed how financial accounting affects costing

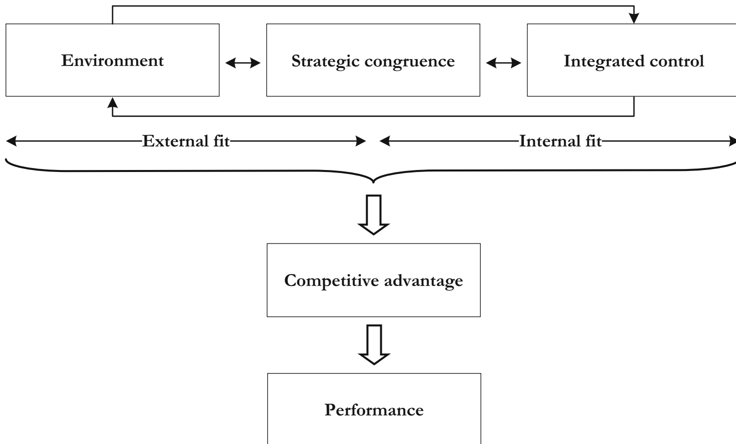

Fig. 2.4 Jannesson et al. (2014) The relationship between strategic congruence, integrated control, competitive advantage and performance, p. 5. (The framework was developed by Nilsson and Rapp (2005) but is also discussed at length in Jannesson et al.)

techniques and inventory valuation. We believe that this is too narrow a focus for several reasons. First, the control system of a company is a "package" of many interrelated components (Malmi and Brown 2008) in which planning (long-range planning, action planning), cybernetic controls (budgets, financial measurement systems, non-financial measurement systems, hybrid measurement systems) and reward and compensation are core components of planning and control systems (see Fig. 2.5). Second, many studies of the relationship between strategy and control, including previous studies published by the two authors of this book in various books and papers, use a broad definition of management control. Therefore we will use the term management control (planning, cybernetic control and reward and compensation) in line with the definition by Malmi and Brown (2008). In our discussion in Chap. 4, however, we will use the terms strategic planning, budgeting, follow-up and analysis and finally rewards and compensation (this choice will be further justified in Chap. 4). We will not include cultural or administrative controls. Even though theses controls can also be affected by financial accounting, such inclusion would risk an overly broad and shallow discussion.

2.5.2 Demands for Uniformity

Principal-Agent theory (PA theory) has gained considerable influence, as discussed above, in the field of financial accounting and in the field of management control as well (Lambert 2007). The reason for that is simple. PA theory is based on the importance of accountability and especially how it is demanded and the structures for doing so. Hence, the separation of "ownership and control" is fundamental

<table>
<tr><th colspan="7">Cultural Controls</th></tr>
<tr><td colspan="2">Clans</td><td colspan="3">Values</td><td colspan="2">Symbols</td></tr>
<tr><th colspan="2">Planning</th><th colspan="4">Cybernetic Controls</th><th rowspan="2">Reward and Compensation</th></tr>
<tr><td>Long range planning</td><td>Action planning</td><td>Budgets</td><td>Financial Measurement Systems</td><td>Non Financial Measurement Systems</td><td>Hybrid Measurement Systems</td></tr>
<tr><th colspan="7">Administrative Controls</th></tr>
<tr><td colspan="2">Governance Structure</td><td colspan="3">Organisation Structure</td><td colspan="2">Policies and Procedures</td></tr>
</table>

Fig. 2.5 Malmi and Brown (2008) Management control package, p. 291

(Jensen and Meckling 1976, p. 309). The owners (the "principals") employ a board and senior executives (the "agents") to run the company and by doing that also delegate most, if not all, of the decisions to the latter. According to Jensen and Meckling (ibid.) this creates the so-called agency problem: the difficulty of ensuring that the agent will act in the best interest of the principal. The authors base their argument on an assumption that both the principal and the agent can be expected to maximize their own utility and that the two utility functions will differ in most cases. Therefore the principal must design a contract that ensures that the agent will act in a way that is satisfactory to the principal. How the agent should be compensated, and for what, are important components of the contractual arrangements. The contract will also affect agency costs, such as the principal's costs for monitoring the activities of the agent. Thus, the contract is extremely important and at the core of all organizational activity (ibid., p. 311, italics and footnote removed):

> The private corporation or firm is simply one form of legal fiction which serves as a nexus for contracting relationships and which is also characterized by the existence of divisible residual claims on the assets and cash flows of the organizations which can generally be sold without the permission of the other contracting individuals. ...Viewed this way, it makes little or no sense to try to distinguish those things which are "inside" the firm (or any other organization) from those things that are "outside" of it. There is in a very real sense only a multitude of complex relationships (i.e. contracts) between the legal fiction (the firm) and the owners of labor, material and capital inputs and the consumers of output.

The authors further argue that the company has many similarities to a market, stating that "the conflicting objectives of individuals (some of whom may 'represent' other organizations) are brought into equilibrium within a framework of contractual relations" (ibid., p. 311). This position is certainly a bit extreme and would not reflect how many researchers and practitioners view the inner workings of a company. However, PA theory can help us understand and analyse the concept of accountability and especially the importance of transparent and comparable financial reports. Central concepts are the information asymmetries between principal and agent and how to reduce them.

External financial reports (and also internal reports to senior executives) are considered to be the foremost structure for reducing information asymmetries. You

only have to look at any financial accounting conceptual framework or corporate governance framework to recognize that the aim of external reporting is to enhance the opportunities for the principal to monitor the actions of the agent. The right for the principal to control and demand accountability from the agent is the basis for the capitalist system and is taken for granted even among many critical accounting researchers.

According to Lambert (2007) financial accounting and management control are used to make decisions about resource allocation, the former across companies and the latter across company subunits. Since the decisions are very similar, basically the same information can be used by both principals and agents. With such an argument, it is not surprising that the demands for uniformity have gained widespread approval. At the same time criticism has been directed against PA theory, for example the treatment of owners and managers as selfish and only driven by maximizing their own wealth. Kaplan summarizes some of the critique in the following way (ibid. 1984, p. 405):

> About the only "managerial" story that gets told via agency theory requires a liberal interpretation of effort aversion as a surrogate for conflicts of interest between managers (the agents) and shareholders (the principals). With this interpretation, contracting is required to ensure that managers do not consume too many nonpecuniary benefits from which managers receive utility but that reduce the principals' wealth (and utility). The overconsumption of nonpecuniary benefits may be an interesting topic for a few researchers to explore. But certainly, developing a theory of the firm, or a theory of managerial behavior, that focuses on limiting expensive carpeting and art objects in executives' offices is not likely to address central managerial issues.

According to Kaplan (1984) the strength of PA theory (and information economics) is that it "offers the potential for a rigorous, analytic theory of management accounting, rooted in the utility and proof-maximizing behavior of neo-classical economics" (ibid., p. 404). Lambert (2007) uses a similar argument, stating: "Like most economic models, agency theory models are not intended to be literal descriptions of the world. Models represent abstractions that are designed to illuminate important structure that is hard to see in the 'mess of so many other factors'" (ibid., 249). The two quotes capture the essence of PA theory and in what way it has contributed to the development of the accounting research field.

In addition, our discussion has shown that PA theory has had an influence on the development of corporate governance practices and the design and use of financial reports in the quest for accountability, especially in emphasizing the role of financial accounting to increase transparency and decrease information asymmetries between the principals and agents. It can perhaps also be argued that PA theory has not really had this influence and that the theory describes practices that are deeply rooted in the capitalist system of the Western world.

Nevertheless, by using some of the analytical concepts of PA theory (e.g. principals, agents and information asymmetries) we can, as earlier mentioned, analyse the concept of accountability and especially the importance of transparent and comparable financial reports at a rather abstract level. However, PA theory does not provide any explicit and detailed explanations why and how financial

accounting is so strongly affected by demands for uniformity. To reach that level of analysis we need theories that are much more closely related to empirical observations of how accounting information systems are changed. Institutional theory has been influential in that respect (cf. Scapens 2006). As discussed in the literature, institutional theory provides us with another and complementary perspective to PA theory regarding what forces affect the design and use of accounting systems (see for example Eisenhardt 1988, 1989; Arwinge 2011).

Institutional theory is a vast research field which we do not claim to cover. We have chosen to focus on the analytical concept of isomorphism as it is used by DiMaggio and Powell (1983)[4] in their much-cited paper. The authors ask why there is such a high degree of homogeneity in how organizations are structured and controlled. The demand for homogeneity—or uniformity (as we have chosen to call it in our framework in Fig. 2.3)—is the opposite of the demand for uniqueness. As discussed above, there are theoretical arguments and empirical evidence for the latter. Many studies based on contingency theory give support to the claim that organizations that align their structures and controls to their unique situation will enhance performance compared to a situation characterized by a low level of alignment. The strong position of contingency theory makes the question by DiMaggio and Powell (1983) even more interesting, and in the introduction of their paper they outline their overall arguments (ibid., p. 147):

> Today, however, structural change in organizations seems less and less driven by competition or by the need for efficiency. Instead, we will contend, bureaucratization and other forms of organizational change occur as the result of processes that make organizations more similar without necessarily making them more efficient. Bureaucratization and other forms of homogenization emerge, we argue, out of structuration (Giddens, 1979) of organizational fields. This process, in turn is effected largely by the state and the professions, which have become the great rationalizers of the second half of the twentieth century. . . . highly structured organizational fields provide a context in which individual efforts to deal rationally with uncertainty and constraint often lead, in the aggregate, to homogeneity in structure, culture, and output.

Isomorphism is an important construct in DiMaggio and Powell's paper (1983). They use the description in Hawley (1968): "isomorphism is a constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions" (DiMaggio and Powell 1983, p. 149). This definition is also very suitable from the perspective of the framework we are presenting since we are especially interested in how the regulative environment affects financial accounting harmonization (cf. Fig. 2.3). The authors use the term *coercive isomorphism* for this type of influence that can be both formal and informal. Examples of

[4] Scapens (2006) discusses three different types of institutional theory: *New institutional economics* (NIE) that "uses economic reasoning to explain diversity in forms of institutional arrangements" (ibid., p. 11). *New institutional sociology* (NIS) that "seeks to explain why organisations in particular fields appear to be similar" (ibid., p. 12) and finally *Old institutional economics* (OIE) that is used to "understand what shapes management accounting practices in individual organisations" (ibid., p. 14). The paper by DiMaggio and Powell (1983) belongs to NIS.

the former are the common legal environment, taxation rules, financial reports etc. Examples of informal influence are cultural expectations to act in a certain way or pressures from similar organizations to make certain decisions. Another type of isomorphism is *mimetic isomorphism*, which has to do with how organizations can cope with uncertainty by so-called standard responses. The advantage of copying solutions from other organizations is that they come at a low cost and can also give some credibility, especially if the organization is successful. The authors have also identified what they call *normative pressure* that is closely connected to professionalization. DiMaggio and Powell argue that in a field in which formal education and professionalization are significant characteristics, a higher degree of uniformity will be the result. Normative pressures are clearly visible in the field of accounting and auditing, for example. Finally, DiMaggio and Powell touch upon the possibility of de-coupling, or in the words of Meyer and Rowan (1977, p. 357) that "The organizations in an industry tend to be similar in formal structure – reflecting their common institutional origins – but may show much diversity in actual practice". Oliver (1991), in a similar line of reasoning, proposes a framework encompassing different strategic responses to institutional pressures (i.e. acquiesce, compromise, avoid, defy and manipulate) (for an application of the framework see Canning and O'Dwyer, 2013). Even though the concept of decoupling has gained a lot of attention in the literature there are also researchers who question the prospects for organizations to decouple policy and practice. Bromley and Powell (2012, p. 498) argue: "In a rationalizing world, with heightened emphasis on transparency and accountability, policy-practice decoupling is increasingly likely to be seen as a moral and operational failure, in contrast to early conceptual depictions that emphasized the legitimacy benefits of decoupling." Instead they see a growing prevalence of means-ends decoupling (i.e. that the daily practices have no relation to outcome). In the following discussion we will focus on isomorphic forces and the possible tensions and conflicts they can help create. We only briefly touch upon how the tensions and conflicts can be resolved by decoupling, for example.

Considering that DiMaggio and Powell (ibid., p. 147) placed a lot of emphasis on the question—"What makes organizations so similar?"—it is no surprise that their paper is cited and used to analyse convergence of financial accounting practices and its effects. For example, Rodrigues and Craig (2007) use isomorphism in their assessment of how IFRS affects international accounting harmonization (they also use Hegelian dialectics and Foucault's concept of knowledge and power). In their analysis they argue that the decision by EU to implement IFRS in quoted companies in 2005 is a formal influence and an example of coercive isomorphism. An example of mimetic isomorphism is companies that are not quoted but use IFRS anyway in order to be viewed as rational and modern. Normative isomorphism, they argue, can be seen in the argumentation of large auditing firms for implementing IFRS—to take only one example. Judge et al. (2010) is another paper using DiMaggio and Powell (ibid.) to study the adoption of IFRS in 132 economies. They found that coercive, mimetic and normative isomorphism is useful in predicting IFRS adoption. They also come to the conclusion, in line with DiMaggio and Powell's argument that the seeking of legitimacy is an important driver for homogenization

(i.e. adoption of IFRS). According to the authors their results suggest that legitimacy is even more important than a pure economic logic. This is an interesting finding since economic logic is often used as the main argument for accounting harmonization.

Finally we find the above-mentioned study by Brandau et al. (2013) especially interesting as it studies convergence in management accounting practice in Brazil and Germany and how financial accounting affects that process. The authors find all three of the different types of isomorphism useful in analysing convergence. If we look more closely at coercive isomorphism, the authors argue that probably the most powerful type of such influence was the introduction of IFRS. Several reasons for this strong influence on management accounting are presented. First, the implementation of IFRS signals that a company is applying the latest and most advanced way of preparing a financial report. Second, and closely related to reason number one, by doing so it will be easier to compete for customers as well as resources such as capital and employees. Third, a new financial accounting regime provides an opportunity to rethink and change the management accounting systems of the company. The authors conclude that isomorphism is so strong that even country-specific differences cannot reverse or halt the process of convergence of accounting and control practices. That conclusion is important since it could explain the observation by DiMaggio and Powell (1983) that there seems to be considerable uniformity in organizational structures and controls. As mentioned, it could also explain why the unique design and use of controls that contingency theory predicts are not always realized. Brandau et al. (ibid., p. 475) even state: "Our results clearly challenge the propositions of contingency theory, which suggests that companies adapt their structures and processes of their environment (Otley, 1980)."

In sum we can thus conclude that there is a strong demand from the outside for uniformity. This conclusion is in line with research studying the level of formal harmonization (Garrido et al. 2002) and material harmonization (Mustata and Matis 2010). Mustata and Matis (2010, p. 51) define material harmonization as "the process of increasing the degree of comparability between standards and practice, and the state of harmony is attained when the variance of the differences between the two elements remains relatively constant". They also conclude that material harmonization "presumes that several companies, placed in the same context, apply the same method for a certain economic transaction or offers supplementary information regarding this economic event (Canibano[sic!] and Mora 2000: 353), and this fact generates a situation in which financial reporting of several companies are comparable" (ibid.).

The study by Garrido et al. (2002), starting with the year 1973 and ending almost 30 year later, shows that the IASC made a great deal of progress in achieving a high level of formal harmonization. Mustata and Matis (2010) have conducted a review of accounting research in the domain of material harmonization covering a period of four decades, starting in the late 1970s and ending in the late 2000s. They point out that material harmonization can exist without formal harmonization (i.e. harmonization of standards) since companies can make their accounting

more uniform and comparable for other reasons than being forced to harmonize. The review shows that the level of material harmonization has successively increased during the period of study, and for the period 2003–2007 the authors (ibid., p. 76) conclude that "the international accounting harmonization process, especially at the level of accounting practice is fully manifested". At the same time there are studies in the review by Mustata and Matis that show how the level of harmonization varies depending on the accounting elements studied (e.g. asset depreciation, goodwill, research and development expenses). Even though formal and material harmonization are difficult to measure in a coherent and precise way, there is no doubt that the demands for uniformity have increased and also led to changes in financial accounting practices. In the next section we will discuss how this development has affected the tensions and conflicts between financial accounting and management control.

2.5.3 Possible Tensions and Conflicts Between Uniformity and Uniqueness

In earlier sections we have discussed the strong force demanding a high degree of uniformity in financial accounting. We have also discussed the demands for a high degree of uniqueness. The overall question of the book is whether, and, if so, how, these demands create tensions and conflicts. Lambert (2007) is one of the researchers that argue that there are many similarities between financial and management accounting. He thinks it is a bit odd that both research and teaching underline the difference (e.g. the former is regulated, not the latter) instead of the similarities (e.g. both information systems are used for resource-allocation decisions). Miller and Power (2013) also discuss how financial and managerial accounting is separated in academia. They explain the separation as a result of two different intellectual traditions: a behavioural turn in which the organization is the focus and a market-based turn in which security prices are in focus. Thus, the former is highly influenced by research from the field of organizations and the latter by financial economics. According to the authors, these quite different traditions could probably explain some of the tensions that can be observed between researchers in the different fields of accounting. They even speak about financial accounting today as representing an "anti-managerial and anti-organizational vector" (ibid., p. 578). At the same time they also acknowledge that the boundaries between financial and management accounting is blurred (ibid., p. 588):

> Furthermore, scholars have drawn attention to the blurred boundaries and interaction between internal and external accounts. On the one hand, Johnson and Kaplan (1987) famously argued that managerial accounting "lost" its relevance precisely because it was in the thrall of external accounting forms and categories. On the other hand, in response to the banking crisis, there is increasing regulatory pressure for greater alignment between internal and external accounting forms, and for greater public disclosure of internal accounting metrics relevant to business models and strategy. The failure to represent risk

> adequately constitutes the latest in a long line of crises of accounting representation, suggesting the latent power of accounting is indissociable from its endemic failure and a dynamic of constant reform.

By describing and analysing the development of accounting as following two intellectual traditions (i.e. behavioural and market-based traditions), Miller and Power also stress that accounting in general is not built on *one* logic but several *different* logics. That type of reasoning is exactly the type of theoretical starting point that we have used in our framework: financial accounting design and use are driven by demands for uniformity, and management control design and use by demands for uniqueness—in other words these two information systems are built on different logics. Since these two demands are the opposite extremes of a continuum, it is reasonable to expect that there will be tensions and even conflicts between the two information systems.

At the same time our literature review shows that there is a tendency towards increased convergence and that the possible tensions and conflicts are not necessarily the same as in the 1980s when Johnson and Kaplan started the "Relevance Lost" debate. One important change, already mentioned, that has created new opportunities for a higher level of integration between financial accounting and management control is the introduction of IFRS. Some of the effects have already been touched upon (see for example the discussion of Joseph et al. 1996). We will now turn to some studies that focus in more detail on how fair values affect decision usefulness both outside and inside the company and whether these effects lessen tensions and conflicts between the information systems.

The first study is by Haller and Eierle (2004), investigating how German accounting rules are adapted to IFRS by presenting and analysing the actions of German legislators. This study has a thorough discussion of the arguments in favour of adapting this regime in line with the conclusions of other researchers (cf. Drury and Tayles 1997; Dugdale and Jones 2003). One of Haller and Eierle's arguments is that IFRS has increased decision usefulness both for owners and managers, compared to the conservative German GAAP, which emphasizes the protection of lenders. The introduction of IFRS also contributes to cost efficiency, since uniform accounting rules make it easier to create an integrated planning and control system for an entire corporate group. Hence, the introduction of IFRS can be a reason to reconsider the separation of financial and managerial accounting that has been the hallmark of German companies. In other words these authors seem to believe that the introduction of IFRS has the potential to lessen the tensions and conflicts between demands for uniformity and demands for uniqueness. Haller and Eierle (2004) also present some arguments against a regime such as IFRS not taking into account the principle of prudence. In a later article Eierle and Schultze (2013, p. 183) also conclude that "Standard setters neglect the information needs of management when setting accounting standards". However, we do not interpret it as a statement that it is impossible to integrate financial accounting and management control since the authors (ibid.) also state that there are important similarities

between the two information systems (e.g. both are used for decision-making and stewardship).

Hemmer and Labro (2008) argue in a similar fashion when discussing the introduction of fair value accounting and how it affects management control based on a theoretical model. The author's opinion is that companies that are impacted by fair value accounting—such as companies in the financial, construction, agricultural and natural resource sector—should find fair values relevant for internal decision-making. The reason is that in these companies the "market value" of assets is very important, and fair value accounting rapidly shows the effects of bad decisions. Therefore it can be expected that companies will use information from the financial accounts in the management control system. That will result in better decisions and hence a higher level of value creation. The authors' argument is built on the premise that in this type of situation the company is prepared to sacrifice the stewardship value that is a characteristic of historical cost accounting in return of higher value relevance. In industries in which fair values are not that important, such as retail and wholesale, the authors believe that financial accounting will focus on enhancing stewardship value. Hence, management control will have a low level of development. The discussion of how the environment and type of industry affects financial accounting and management control is an important contribution to our discussion, since it shows that tensions and conflicts are affected by the situation. In that respect the authors are close to proposing a contingency theory for financial accounting.

Finally, we will discuss a paper by Barlev and Haddad (2003) that also analyses fair value accounting and decision usefulness. However, the conclusions are not entirely the same as those of Hemmer and Labro (2008). Barlev and Haddad argue that fair values have the potential to reduce information asymmetries and agency costs, in other words they help to enhance the stewardship function. According to the authors fair values reflect reality, and they are also more difficult to manipulate. Historical cost accounting, on the other hand, creates reserves that are hidden from the owners and can be used by managers to hide poor performance. Since fair value accounting has many advantages—for example high decision relevance—the authors believe that it will also lead to changes in strategies and control systems. More transparent financial reports are in the interest of owners and will help to protect shareholder equity. At the same time they acknowledge that historical cost accounting will still exist and that the company could benefit from having dual systems. They also believe that risk management will be more integrated with the accounting systems. In sum the authors do not seem to believe that there is a significant conflict between stewardship and value relevance (cf. Eierle and Schultze 2013). They also seem to apply the view that in principle there should be no difference between the information needs of the different stakeholders of a company.

In sum, these studies show that it is not self-evident whether and in what way there are tensions and conflicts between financial accounting and management control. Instead they show that there could be situations in which the demands for uniformity and the demands for uniqueness can be combined. Studies also indicate

that we have reasons to believe that demands for uniformity do not affect all parts of the management control system. Some parts of the information systems will converge and some will not. In a similar fashion the effects of convergence and non-convergence will probably differ among firms as well as within firms. Finally, a more principles-based accounting regime, like IFRS, creates some leeway for companies to decide how to portray their performance in the financial accounts. In some of the standards, such as segment reporting, this is even the desire of the regulators. Because of this, there is a possibility that the management control system will affect financial accounting to some extent. We can thus finally conclude that the possible tensions and conflicts between financial accounting and management control must be analysed in a detailed fashion. We will do this in Chaps. 3 and 4 in the book.

Finally some words about our choice of using several different theoretical perspectives in our analysis of tensions and conflicts. Within the field of institutional theory the tension between the "outside" and the "inside" of organizations is acknowledged (Scapens 2006). To study how "behaviour within economic systems (and organisations) can become institutionalised: i.e. embedded in and shaped by institutions" (ibid., p. 14) the framework devised by Burns and Scapens (2000) is often used. However, we have chosen not to use this framework even though it would have been possible to relate it to the concept of isomorphism and our discussion of the outside demands for uniformity. Instead, and as motivated in earlier sections, we have chosen to use contingency theory. The reason is our strong interest in studying the tensions and conflicts between uniformity and uniqueness. Contingency theory serves that purpose better since it has a strong focus on what makes control systems differ. Institutional theory, on the other hand, as interpreted through the Burns and Scapens framework (2000) is "useful in trying to understand stability; why accounting systems are slow to change; and how institutions shape rules and routines" (Scapens 2006, p. 25).

There are many examples in the literature of studies combining insights from institutional and contingency theory (e.g. Gupta et al., 1994; Ketokivi and Schroeder, 2004; Albu and Albu, 2012; Tucker and Parker, 2013), showing that they provide different and complementary perspectives since "neither perspective can, on its own, explain the success of firm behavior and the firm's relationship with the environment" (Volberda et al., 2012, p. 1040 f). By contrasting our findings with the insights from institutional theory and contingency theory, as well as PA theory, we believe that the analysis will be richer and deeper, since it is built on different and complementary perspectives. We would like to stress however that we do not claim that our discussion of these perspectives and the related studies is in any way exhaustive. The research areas are too broad to allow even an attempt to provide such an overview in a single volume like this one. Our ambitions are much more modest. We are using some fundamental insights from these perspectives to enrich our discussion and analysis of the complicated relationships between financial accounting and management control.

2.6 Conclusions and Implications

The chapter started by describing one of the most influential debates in accounting history, the so-called "Relevance Lost" debate. Building on North American data, Johnson and Kaplan (1987) argued that management accounting had lost its relevance. The main reason was the influence of financial accounting on management accounting. Even though these systems have many similarities, they are also different in many important respects. If that was not the case, companies would not have two separate accounting systems since the costs of running these systems are huge.

The "Relevance Lost" debate inspired many researchers to study whether financial accounting really affected management accounting (control). The results from these studies, most of them conducted in Europe, were mixed. Some studies showed an influence and some did not. After the introduction of IFRS in 2005, there was a revival for studies of the relationship between financial and management accounting. This time the results were different. It seemed that IFRS, especially fair values, could enhance decision-relevance to stakeholders both outside and inside the company. Introduction of new IT-solutions also contributed to enhancing the possibilities for integrating different accounting information systems.

Ever since Johnson and Kaplan published *Relevance Lost*, there have been many efforts directed towards developing models and frameworks for analysing and managing the relationships between accounting information systems. Some of these models—such as the Balanced Scorecard—were basically presented as a solution to the problems identified by Johnson and Kaplan. We would argue that they succeed in that endeavour and also brought the importance of aligning strategy and control to the forefront of management control practice once again. Even though these models and frameworks were important and timely contributions to the accounting field, most of them did not explicitly use established theories for analysing what affects the design and use of information systems and in what ways. The theoretical framework that is presented in this chapter and will be used for further analysis in the two following chapters has been developed to address that void in the literature.

The framework uses insights from PA theory and institutional theory to analyse and explain the demands for uniformity in financial accounting. Insights from contingency theory is used to analyse and explain the demands for uniqueness in management control. These two demands can create tensions and even conflicts between the two information systems. Some of these can probably be resolved, while others are unsolvable. In some cases there are no tensions and conflicts, since the demands for uniformity are in line with the demands for uniqueness. The conclusions and implications that can be drawn from this chapter are that the relationships between financial accounting and management control are fuzzy and complicated. There is no simple solution or answer to what this relationship looks like and how tensions and conflicts should be handled. The framework that we present in this chapter shows this. In the next chapter we will use it to provide some

answers but also to formulate new questions about the relationship between financial accounting and management control. As mentioned, the framework is conceptual in character and, as the conclusions are tentative, they should be tested in future research.

Chapter 3
Financial Accounting Standards: Some Examples

3.1 Introduction

In this chapter, we present four examples of financial accounting standards in order to discuss and illustrate the tensions and conflicts between financial accounting and management control. We depart from changes in financial accounting standards (i.e. IFRS), and discuss and illustrate the different effects that these changes may entail for organizations. The examples have been chosen based on an explorative study, where accounting experts were interviewed about what accounting standards they see might give rise to local resistance (see also Sect. 1.8).

Possible tensions and conflicts between external demands and internal demands are discussed in different ways depending on the kind of standard being studied. One example directs attention to questions of strategy, whereas other examples direct attention to planning or decision-making. Also, the examples highlight tensions and conflicts relating to different aspects of the management control process. Sometimes, changes in accounting standards have unforeseen effects, which we discuss as important tasks for future research to investigate in depth. In this chapter, we do not base our analysis on case studies of actual effects; rather, the purpose is to discuss on a conceptual level the possible tensions and conflicts that exist based on the discussions surrounding the change of each accounting standard. In other words, the analysis presented is tentative and explorative in character.

In the previous chapters, we have discussed uniformity and uniqueness as two contrasting concepts. There has been an ambition to make financial accounting more uniform at various points in time. However, it is most often intertwined with the concept of comparability. Comparability is also what is stated as one of the purposes of IFRS in the IFRS Framework. Hence, even if we are interested in the conflict between uniformity and uniqueness, the term that is most often used in practice is not uniformity but comparability. This is also connected to the intended use of financial accounting; it is not valuable per se to have uniform accounts across companies; accounts must be comparable in order for owners and funders to be able

© Springer International Publishing Switzerland 2015

F. Nilsson, A.-K. Stockenstrand, *Financial Accounting and Management Control*,
Contributions to Management Science, DOI 10.1007/978-3-319-13782-7_3

to make decisions. However, the concepts of uniformity and comparability are closely interrelated.

In each of the following sections we start by describing a financial accounting issue and some changes that new standards brought about. After this we discuss how the conflict between financial accounting and management control arose in the discussion surrounding the change. In the last part of the chapter, we summarise the different ways that companies may have dealt with the possible tensions and conflicts and analyse why changes in accounting standards can lead to different solutions and what we can learn from these observations. These observations also show that the introduction of accounting standards striving for uniformity does not guarantee comparability.

Finally, we would like to stress that the financial accounting issues that we discuss are all complex and so are the accounting standards. Due to their complexity, the large number of changes, and the fact that some changes are gradual and are made over long periods of time, it is impossible to cover them in any detail in a volume of this kind. Instead we will provide the reader with short overviews, with a focus on what we believe are important apects for discussing the relationship between financial accounting and management control. Readers interested in learning more about these standards can find detailed information on the webpages of regulators (e.g. IASB and FASB) and the large auditing firms.

3.2 Segment Reporting

3.2.1 Background

The accounting standard of segment reporting is an interesting example, not least because of the explicit aim of accounting standard setters to move closer "into" the company. They have developed a new standard where accounting for different segments takes its departure in the internal organizational structure, and actually mirrors how decisions are made internally. Segment reporting is also interesting because it is widely used by companies in all business sectors. Segment reporting is generally seen as providing the possibility of analysing the strategy of a company and the potential synergies within it. It is seen as essential for providing information about business performance and risks that are associated with that performance.

In November 2006 the IASB issued IFRS 8 *Operating segments*. The new standard meant that the IASB took another step towards convergence with the generally accepted US accounting principles and the standard SFAS 131 *Disclosures about segments of an enterprise and related information*. The new standard IFRS 8 replaced the old standard IAS 14 (*Segment reporting*) and aligned the standard with SFAS 131. SFAS 131 was adopted in the US by FASB in 1997 and had the objective of decreasing the discretion that existed as a result of the previous standard because of the unclear definition of "industry". Managers could thus report

many different and diversified operations as being in one broad and vaguely defined "industry segment" (FASB 131, §58). Instead, in SFAS 131 and IFRS 8, a "management approach" was adopted, in an attempt to reduce subjectivity and to increase insight into how the company is managed.

IFRS 8 also requires companies to use the management approach in reporting the performance of each operating segment with information that management uses internally for evaluating and making decisions regarding resource allocation to segments—that is, viewing the operations "through the eyes of management". However, since this information would have a close connection to internal reporting this creates an additional need for explanations about the preparation of segment reporting and its connection to income statement and balance sheet. Under the previous standard IAS 14, segments were to be identified based on risk and return in either products or services (business segment) or in the economic environment (geographic segment). Under IFRS 8, however, operating segments may be defined by product or geographic area or something else, as long as it follows management's internal decision-making process for allocating resources. Management is here defined as the Chief Operating Decision Maker (CODM).

As Sir David Tweedie, the former chairman of IASB, said in connection to the issued Exposure Draft of IFRS 8 in early 2006, the IASB believed the new standard should mean that companies would be able to provide timely segment information at little extra cost. Since information used in external reporting of segments' performance was to be the same as internal information used, one should expect that the conflict between financial accounting and management control should decrease.

3.2.2 Tensions and Conflicts Between Uniformity and Uniqueness

Companies did not completely embrace the new standard that would force them to provide sensitive information at strategically important levels. The critique against IFRS 8 mainly had to do with decreased comparability, in that different chief operating decision makers in similar companies could use different measures internally in evaluating similar segments. Also, other criticism has been levelled, for example that reorganizations in companies would mean decreased capacities to analyse trends in segment performances, but perhaps most of all that management generally is given too much control over the formation of the reporting (Nichols et al. 2013). However, the amount of information externally available seems to have increased, through a larger number of segments being reported, though in some jurisdictions the number of reported segments did not change at all (cf. Nichols et al. 2012). From the company perspective, there is reason to believe that even though relevant and faithful information to owners and funders is important, there may also be understandable reasons why a company may not want to expose information such as their margins on different products to competitors (IFRS Foundation 2013a).

According to a post-implementation review conducted by the IASB (IFRS Foundation 2013a) the internal demands and motives that may be opposing a "true" mirror of how segments are controlled internally may take on different forms. Companies could use the identifications criteria so that they portray certain segments more favourably, or they could allocate costs in new ways so that profitability in various segments is changed. Also, since a company may be reluctant to provide full transparency, mainly in relation to competitors, organizational responses may appear that in some way hide the real internal decision-making structure. According to the IFRS Foundation there were many expected issues (both advantages and disadvantages) in imposing the standard. We will discuss some of these issues below, based on a comment letter process in 2006 (ibid., p. 10).

One issue is related to formal and material harmonisation of accounting standards. Creating greater consistency between financial accounting standards in different jurisdictions does not mean that segments will be accounted for consistently in all cases. This is an example of how principles-based accounting standards do not automatically create uniformity, even though convergence with US GAAP was mentioned as an expected benefit.

A second issue highlighted by the IFRS foundation is the concept of relevance, and the emphasis on users' information needs to be able to better predict future cash flows by using a "management eyes perspective". This perspective can be contrasted with another problem—that the internal workings and decisions of the company will not always be guided by the users' need for comparability and consistency, but by entirely different motives such as the need for strategic purposes, for cost purposes or for restructuring purposes. It is difficult to know how much of such restructurings would be guided entirely by the motive to obscure transparency in the annual reports, but it is perhaps sufficient to conclude that if a company wishes to limit transparency, it can do so. Since a management control system is designed and used to accommodate internal needs and motives, there may be many reasons to restructure an organization, which means that the advantage of predicting cash flows can be partly lost (e.g. through loss of trend data).

A third issue highlights the kind of information that a principles-based standard promotes. The essence of principles-based accounting standards is linked to the principal-agent problem where researchers have debated the matter of earnings management, or even "aggressive earnings management" (Okamoto 2011), and what it is that causes this behaviour, or rather best hinders it. Segment reporting according to the new standard would mean a managerial judgement, a judgement that actually says something about how the company is run and deals with its risks, rather than simply dividing it according to geographical areas (however, loss of geographical data was considered to be a potential disadvantage). The latter would not require a particularly large amount of "professional ethical judgement" (ibid., p. 241), which is what standard setters developing principles-based standards ultimately strive for. At the same time Okamoto (ibid., p. 240) concludes that "both principles- and rules-based accounting standards carry the risk of leaving room for AEM" (AEM is an abbreviation for "Aggressive Earnings Management").

It is also interesting to reflect on the relationship between principles-based standards and what such standards mean against the background of the principal-agent problem and especially the existence of information asymmetries. For example, Hodder and Hopkins (2014) suggest that managers that receive higher private benefits in their operations have incentives to resist increases in financial-reporting transparency. They study comment letters from bank representatives regarding the FASB 2010 exposure draft in which it is proposed that most financial instruments should be measured at fair value.

Finally the IFRS foundation identified an issue that is connected to another aspect of the qualitative characteristics stated by the IASB, namely understandability. Accounting standards cannot merely be theoretically correct, or practically feasible; in order to have any value they must also promote a kind of financial reporting that users can understand. In the case of segment reporting, it is concluded that even though external users would probably find it relevant to be given non-IFRS measures defined and used internally, they may still become useless. These measures would be difficult to understand, and especially to compare with measures in other companies. Furthermore, it is interesting to note how the use of non-IFRS measures by management is considered a possible "disadvantage" to external users according to the IFRS foundation. This would mean that an internal language, based on the company's own unique history, traditions and local needs, would not be the most appropriate language to use in the organization for the sole reason that it cannot be entirely understood by external stakeholders and therefore cannot be used in comparisons. Even though it is easy at first glance to understand the reasoning behind this argument, we believe it is difficult to imagine a company that would eschew any internally defined measures in order to run their business in favour of externally defined and standardised measures. Such a situation could possibly be problematic, something that we will return to and discuss further in the next chapter.

Some research has discussed the above possible tensions and conflicts between relevance and comparability, and some of them were also covered in the following post-implementation review (IFRS Foundation, 2013a). Paul and Largay (2005) argue that even though the management approach has led to more segment data being reported, it is not clear whether or not this actually has benefited users. The main reason for this is uneven compliance among companies, partly connected to problems in the company-auditor relationship. The authors even found two cases of accounting fraud, where companies had taken measures to obscure segment information. The authors discuss that the change in accounting standards also means a change in how the market should perceive financial information, in that it cannot be seen as a fully transparent image of the business, but rather as an image of managerial intent. Moreover, users cannot replace in-depth knowledge about a company's business activities with data reported by an entity. The authors also discuss users' needs and how users' general orientation towards the future and the economic substance of information drives developments towards an increased amount of information that needs to be disclosed. For example, it is not enough for the company to disclose profitability, risk or liquidity measures for each

segment; the company would also need to describe how segments are aggregated, what transactions between segments look like and so on.

Paul and Largay (2005, p. 309) conclude that the management approach to segment reporting is beneficial for users seeking to understand individual companies (if reports do reflect actual internal decision-making), but disadvantageous to users wanting to compare companies. This also points to the issue of users and the problems of grouping users into one single group. This has been discussed by Young (2006), who argues that it is a fundamental problem for the IASB that they assume a coherent group of users with a coherent way of using financial information. This also highlights the tension between uniformity and uniqueness that exists also from a user perspective. As a final remark, Paul and Largay (2005) argue that one must also bear in mind that even though there may be problems with comparability in the management approach to segment reporting, it is not certain that comparability was much better under the previous standard. What research seems to indicate is that the management approach to segment reporting seems to increase managerial flexibility (Nichols et al. 2013). However, many other effects have also been uncovered that are interesting to discuss further.

Street and Nichols (2002) analysed the effect of the move from IAS 14 to IAS 14R (revised) in the disclosures of 210 companies. They found several effects of the move, for example that there was a significant increase in the number of items that were disclosed for each primary but also secondary segments. Further, they found a significant increase in compatibility between the information reported in the segment information, with the information presented in the introduction of the annual report as well as the management discussion and analysis part, something that created consistency throughout the report. In some instances they found that all information required in IAS 14R was not reported, but in general, information disclosed increased in volume. Also, they found that the number of companies that reported more than one measure of segment profitability increased. These measures were largely non-IFRS measures, but most companies did tie these measures directly to the consolidated income statement, meaning that they could be understood more easily. Finally, they found a significant decrease in the number of companies that claimed to be operating in only one segment. Most companies based their segment reporting on lines of business.

The last finding is perhaps the most intriguing. The first two findings show an increase in both amount of information disclosed and in the consistency of the information presented in different parts of the annual report. This should entail better insight into, and a better understanding of, the company's operations. The third finding shows that companies to a greater extent report that they operate in more segments than previously. There are several possible explanations for this. One is that this is in fact the case, and that the new accounting standard forces companies to disclose this. However, it is not rare for companies to claim to be in mainly one line of business, perhaps meaning that the new standard will obscure what segment is actually the most important segment for the company. Only one company in the sample was found to move from reporting multiple segments to reporting only one segment.

It seems as if identifying segments is a great challenge. It may appear that the internal decision-making model would provide a simpler process for identifying segments. However, identifying operating segments is still a major challenge, and the first part of that challenge would be to identify the company's CODM. This would be easy if all companies had such a decision maker clearly appointed; however, this is not always the case, and in many companies this purported decision maker is not one single individual. The CODM not only makes decisions regarding the segment, but also follows up its development and makes regular reviews to assess its performance. Several effects could be possible here, for example a clearer structure of decision-making could develop. Also, if the process of reviewing the results of each segment is disclosed and described, and the internal decision-making is externally exposed, this may have an effect on how it develops in practice—something that we will discuss in more detail in the next chapter. On the other hand, if most companies report an increased number of segments, with an increased number of measures, the internal decision-making structure may also appear more complex. Another interesting issue is that changes in one accounting standard may cause changes to information and considerations in other accounting standards. In the case of IFRS 8, there may be a connection between the identification of operating segments and the determination of goodwill. This is something that future research may find fruitful to investigate further.

3.3 Goodwill Accounting

3.3.1 Background

The history of regulating goodwill accounting is interesting and important. For a long time, there were two different methods that could be used when accounting for business combinations. This is connected to the often-used term "mergers and acquisitions", which implies that there are two different events that could happen when a new company is created. The first is a merger and the other an acquisition. In the world of accounting, a merger is very different from an acquisition in that it involves two equal entities that simply merge together. Thus, neither company is buying the other. However, in the other case, a buyer and a seller can be identified. And because there is an acquisition, a price is paid, a price that is most often higher than the value of the net assets. This is what gives rise to goodwill in the new consolidated statement. The two different situations meant that two different accounting methods were to be used: in the case of merger the pooling of interests method, and in the case of an acquisition, the purchase method. However, since the pooling of interests method did not give rise to any goodwill, for many years this method was much more popular than the purchase method, especially in the US, since goodwill had negative effects on profits (cf. Beresford 2001).

The pooling of interests method was originally intended for mergers that were more formal than substantive in character, for example two subsidiaries within a group and where the merger of the two companies' book values logically would not lead to any write-up of assets or any additional earnings (Kam 1990). However, the pooling of interests method became increasingly popular even in other circumstances, something that Kam (1990) explains by the fact that many accounting professionals were afraid of the overvaluation of assets after the stock market crash in 1929 and for that reason found pooling particularly appealing. The popularity of the method could also be seen in a gradual relaxation of the criteria to qualify for its use, until the 1960s where the only remaining criterion was the continuation of ownership (Hughes 1982).

However, in the 1960s, the US Securities and Exchange Commission (SEC) started to acknowledge that the use of the pooling method was causing problems, and complained about companies abusing the pooling of interests method in a way that created difficulties both for those overseeing the companies but also for owners and funders who did not get a truthful image of the economic transaction and its consequences. This led American standard setters to discuss the issue in the 1970s, a discussion that never led to a new project. However, in 1991 the SEC commissioner asked the FASB to put the issue on their agenda again. The following process was a long tedious one, and it was not until the completion of the Business Combination Project conducted by the FASB between 1996 and 2001 that the pooling of interest method was finally eliminated. The project ended with the standard SFAS 141 *Business combinations* that only allowed business combinations to be accounted for using the purchase method. The strong opposition included large and powerful companies, as well as representatives of Congress and various politicians that became passionate about the possible negative effect the new standard might have on US merger activity (Beresford 2001): it was even perceived as a possible threat to the existence of the FASB. As a compromise to deal with this strong opposition, changes were finally made to the treatment of goodwill. As the only solution, in order to succeed in eliminating pooling, it was decided that goodwill would no longer be subject to systematic depreciation, but to annual depreciation tests (SFAS 142 *Goodwill and other intangible assets*). Shortly after this, the IASB took a similar stand, which resulted in the IFRS 3 *Business combinations* in 2004 as well as revisions to IAS 36 *Impairment of assets* and IAS 38 *Intangible assets*.

Some argue that SEC forced FASB to deal with the "pooling situation", even though SEC denied any such involvement (Beresford 2001). Irrespective of the true circumstances in this specific case, the different views presented in the literature pinpoint the conflicting interests between regulators, enforcers, companies, owners and funders. Another important factor in the outcome of the US accounting regulation process was the wide-ranging international movement of creating one globally accepted set of accounting standards. Even though there have long been many disagreements between the FASB and the IASB, the two have been working on a joint project since October 2004, when it was decided that they would start developing a common conceptual framework, based on both the existing IASB

framework and the existing FASB framework. The new conceptual framework would be used by both standard setters as a point of departure when developing and revising accounting standards (For more information about this joint project, see www.fasb.org).

Given that the two standard setters had decided on such a far-reaching agreement in 2004, one can imagine that the IASB's views on business combinations and goodwill were influential in the FASB decision even a few years earlier. According to Beresford (2001) FASB argued in their exposure draft "Business combinations and intangible assets", issued in 1999, in favour of eliminating the pooling method and decreasing the amortization of goodwill from 40 years to 20 years. Some of those opposed to this draft were highly critical, especially of the suggestion to eliminate the pooling method and of one of the reasons for that suggestion—that the US should harmonize its accounting regulations to a global accounting regime.

The new accounting model of impairment testing is interesting in many respects, not least because it also highlights the issue of disclosures. The reasons for writing down or not writing down goodwill must be disclosed in order for an investor to understand financial statements. But also, the actual procedure of testing must be disclosed, such as key assumptions (e.g. growth and discount rate used). IAS 36 therefore requires a high degree of disclosure of information about the impairment test of goodwill, requirements that are more far-reaching and detailed than for other assets. IAS 36 requires disclosure of for example:

- The impairment amounts, as well as the circumstances that caused the change in value.
- Amounts of goodwill per cash-generating unit(s).
- Information about the valuation method applied and approach in deciding on basic assumptions.
- Key assumptions used in valuation, such as growth and discount rate used.
- A sensitivity analysis that shows what would happen if key assumptions were to change.

Having presented some major changes in the standard for goodwill accounting, we will now go on to discuss the tensions between uniformity and uniqueness that seem to arise in this area of financial accounting.

3.3.2 Tensions and Conflicts Between Uniformity and Uniqueness

The increased number of disclosures needed in order to understand the financial accounting of the company using the new standard for goodwill accounting is interesting from the perspective of uniformity and uniqueness. As stated by Zeff (2007) the SEC has long been a strong proponent of uniformity, and with the elimination of the pooling of interests method, the standard for goodwill accounting

also became more uniform, since it eliminated a choice between different accounting methods. However, with the abolishment of systematic amortization of goodwill and the introduction of impairment testing, and as a result of that a need for more disclosures, a lack of uniformity is paradoxically likely to appear.

In the FASB post-implementation review conducted by the Financial Accounting Foundation (FAF 2013) about business combinations, it is stated that the FASB had expected comparability to be improved as a result of the elimination of an alternative method of accounting for a business combination in which one company obtains control over another. The IASB also acknowledged in their post-implementation review (IFRS Foundation 2013b) that some constituents had concerns, for example about whether impairment tests would be able to present negative economic cycles in financial statements in a timely manner, or if impairments for various reasons were done at other times than when the economic cycle would indicate (meaning that the value of goodwill would not follow the market). Also, there were concerns about the high number of assumptions that would be needed in the calculation of the impairment, and that the information would consequently be too subjective. In the American post-implementation review done by the FAF (2013) the various effects of the new standard relating to the possible tensions and conflicts between different stakeholders, their needs and motives were discussed. The review investigated whether the standard had entailed that (ibid., p. 5):

- Decision-useful information was being reported to, and being used by, financial statement users.
- The standard is operational, meaning possible to implement practically.
- There had been any significant changes to financial reporting or operating practices as a result of applying the standard.
- There had been any significant economic consequences as a result of the standard.

The term “economic consequences” is used for consequences such as changes in the value of companies, or changes to their operations, changes to financial markets and economic activity. It should be noted that the changes made to both SFSA 141 and IFRS 3 include much more than we account for here. In this discussion we have focused on the main changes to the standards. In the following section we will continue to discuss other aspects of the new standards.

Some research has addressed the consequences of the new model for goodwill accounting. Olante (2013) studied whether SFAS 141 and SFAS 142 improved the ability of accounting to capture, in a more timely manner, a situation where goodwill was overstated and should thus be written down. This was done by examining the causes of impairment losses. The author concludes that what in fact causes these losses is that an entity was overpaid initially, something that is usually corrected in the impairment. Then the author also investigated whether goodwill was indeed impaired when it should have been, and found that about 40 % of all goodwill impairments were predictable when using overpayment indicators, and in the cases were there was a time lag it was usually between 2 and 3 years. To

conclude, the author argues that the SFAS 142 requirement for annual impairment testing was necessary to improve the timeliness of the recognition of impairment losses.

However, several challenges have been found in practice, not only relating to the timeliness of goodwill impairment but also to the actual testing when impairment was done. A report by the European Securities and Markets Authority (ESMA) presents an analysis of accounting practices regarding impairment testing of goodwill and other intangible assets. It summarises observations from 235 issuers with significant amounts of goodwill in 2011 financial statements (ESMA 2013). ESMA acknowledges that after times of financial crisis and a poor outlook for economic development, assets in any industry may have been devaluated and should be impaired. However, ESMA found that in 2011 significant goodwill impairment losses were limited to very few issuers, and these were mainly in either the telecommunication industry or the financial sector. Because of this, they question whether the level of impairment does in fact correctly reflect economic reality.

An important insight they highlight is the additional disclosures related to impairment testing. They found that much information was standardised in nature, and not entity-specific—something that we find particularly interesting, since it implies that companies in this area chose to report according to a more standardised (and thus more uniform) method. Also, to some extent problems with a lack of specificity in the standard about disclosures were identified, especially regarding sensitivity analysis. This is not surprising and pinpoints a recurrent and inherent problem in principles-based standards where professional judgement rather than bright line rules (meaning the detailed rules in rule-based standards) is the point of departure. However, the effect of this, something that ESMA also mentions, is a lower degree of comparability or transparency, since it is difficult to know what practices and procedures are hiding behind the standardised descriptions of the impairment testing. It appears that a principles-based accounting regime allows for the obscuring of organizational practice behind, more or less, standardised descriptions. At the same time we acknowledge the difficulties of clearly separating principles-based and rule-based regulations. Even a regulation that is considered to be based more on principles than rules can have detailed instructions for how to account for a certain activity. Furthermore, ESMA (ibid., pp. 3–4) brought up five areas of concern that we will discuss one at a time below, since they are highly interesting with regard to the tension between uniformity and uniqueness:

Key assumptions of the management In the sample used in the ESMA analysis, key assumptions that had been used by management in the impairment testing were disclosed by only 60 % of the issuers. And of these, half did not even include entity-specific information that was required by the standard. In total about 70 % of companies did not provide sufficient disclosure on key assumptions, something that according to ESMA meant that information was not as useful to owners and funders as it could have been.

Sensitivity analysis One interesting area is the practices with regard to the required sensitivity analysis. ESMA found that disclosures concerning this analysis evinced

a lack of consistency. The main problem seemed to be connected to the standard being unclear regarding in which cases a sensitivity analysis should be provided. In companies where the book value of net assets was higher than the market capitalisation, ESMA found that only half of the companies provided a sensitivity analysis with a description of effects of changes in key assumptions.

Determination of recoverable amount In conducting the impairment testing, the book value of goodwill must be compared with some other value that reflects the economic reality of the present. The impairment loss is a fact in the case where the carrying amount of the asset (or to large distance cash-generating unit) exceeds its recoverable amount, which is the higher value between the asset's fair value and its value in use (IAS 36). According to ESMA, most companies apply the value in use alternative to determine goodwill. This is not surprising since it is often more probable that the goodwill acquired has higher value to the acquirer than to an organization that is not part of the particular business combination. Because of this, the challenge is to determine future cash flows that will be generated from goodwill and that can be discounted to a value in use by using entity-specific assumptions. However, companies that did use cash flows to estimate the fair value (less costs of selling) also to large extent used entity-specific assumptions, something that ESMA found worth noting. In order to establish a fair value, ESMA says that it would have expected more external sources of information to be used.

Determination of growth rates In the analysis of the choice of growth rate, ESMA found that more than 15 % of companies had used a growth rate that exceeded 3 %. ESMA concludes that this seems too optimistic an outlook on the future given the economic environment and what the prognosis of growth looked like in 2011.

Disclosure of an average discount rate In the disclosure of discount rates, ESMA found that about 25 % of companies disclosed an average discount rate instead of specific discount rates for each cash-generating unit. ESMA expressed concern about this finding, since even small changes in specific discount rates can have large effects on the calculated value. Also, different cash-generating units can differ in their risk profiles, meaning that important information is hidden by providing only an average discount rate.

The ESMA report highlights several challenges regarding the new standard. A first challenge is that increased scope for managerial interpretation creates a need for disclosures with regard to assumptions, choices and many details especially in relation to the use of theoretical fair value models. A second tension highlighted by this example is that even though regulators may succeed in making accounting standards more uniform in terms of accounting methods, the uniqueness of each company will still materialize in the actual application of that method. It is then up to disclosure requirements to deal with these disparate ways of using the accounting method, in order to still achieve comparable and useful accounts to owners and funders. There appear to be persistent concerns about having only one option to use when accounting for a business combination. This means that the old discussion that had been going on in the US for decades is still not settled. For example the

Swedish Financial Accounting Standards Council (In Swedish "redovisnings-rådet") raised the question as early as 2004 that it seemed strange that very different situations, even where it was difficult to identify an acquirer, would be accounted for in the same way, that is, that all business combinations would be accounted for using the purchase method. We will now go on to discuss the other part of the change to accounting for business combinations, namely the change in IFRS 3 that all assets and liabilities should be accounted for at fair value in an acquisition.

3.4 Business Combinations

3.4.1 Background

The IASB began a new project in 2001 to review IAS 22 *Business combinations*. The project ended in 2004 with the introduction of IFRS 3 *Business combinations* (superseding IAS 22). One of the objectives of the standard was to seek international convergence. The changes to the standard included many things, but most importantly against the background of our discussion, it was decided that all business combinations were to be accounted for using the purchase (or "acquisition") method, and that the pooling of interests method would no longer be permitted. Also, goodwill that had been acquired in a business combination was no longer to be amortized but instead to be subjected to annual impairment testing. In a second phase, the FASB and the IASB decided that they would work together to further revise their standards. This second phase included developing guidance for applying the acquisition method and resulted in exposure drafts of revisions to both IFRS 3 and SFAS 141 and some other related standards. The revised standards were then issued in 2007 (SFAS 141 *Business combinations*) and 2008 (IFRS 3 *Business combinations*). It should be noted, however, that even though the two standards were changed in a way that made them more similar, differences still existed. The main change in the standards was that the acquisition method should be used in a way that requires assets acquired and liabilities assumed to be measured at fair value at the acquisition date.

The measurement of assets and liabilities at fair value raises many questions, such as how intangible assets and contingent liabilities should be identified and valued and what assumptions should be made in measuring and determining useful lives of assets. However IFRS 3 does not include detailed guidance on how fair values should be measured. Essentially, the accounting model applies a "fresh start" in accounting, departing from the idea that as a result of the business combination a new entity emerges. Because of this, it is also logical that fair value measures should be used, reflecting the new entity at the date of acquisition.

The first step is to identify the acquirer. This is a subjective decision, but one that can usually be based on some indicators, or a combination of indicators, such as whether the fair value of one of the entities is significantly greater than the other or

the business combination results in a situation in which one entity can influence the management team of the combined entity to a larger extent. In some cases this can mean that the acquirer in legal terms may not be the same as the acquirer for accounting purposes (Deloitte 2004). Fair values of assets are recognised if the value of an asset can be measured reliably and if it is probable that any associated benefits will flow to the acquirer. The same holds for liabilities: their value must be possible to measure reliably and it must be probable that a future outflow will be required. The standard also discusses other aspects of business combinations such as the requirements for provisions for restructurings. However, in this section, we will focus the discussion on the effects of fair value measurement on business combinations. There are also other related issues, such as the requirement that all intangible assets must be accounted for and separated from goodwill.

3.4.2 Tensions and Conflicts Between Uniformity and Uniqueness

Measuring all assets and liabilities at fair value in an acquisition poses multiple questions. The change in 2004 meant that all assets and debts should be valued at fair value in the purchase price allocation, but it did not prescribe how this should be done in practice (the guidance for preparers was developed further in a revised draft in 2008). Also, the new standard meant that intangible assets should be accounted for separately, meaning that different assets such as customer relationships, information systems and company brands have to be valued separately. Identifying and valuing these intangible assets thus became the hardest part of the purchase price allocation, where the buyer is often dependent on the seller to produce or provide access to the information that valuations are based on. One possible consequence here is that the need for accountants, auditors, lawyers, and valuation experts will increase in importance for an acquisition to be carried out. Not only will their expertise be needed for knowledge purposes, but external experts will possibly also be necessary to resolve the delicate tension between buyer and seller in acquisitions. It is also possible to imagine that the whole structure of the negotiation will be affected, since both parties will have an incentive to try to affect the valuation process. It is then interesting to ask whether the new accounting standard could have an effect on what acquisitions are actually made. In other words, does the standard have any effect on acquisition strategies?

In an effect study conducted by the European Commission in 2008, the potential effects of IFRS 3 in the EU were analysed mainly focussing on issues that had been raised by the IASB and the European Financial Reporting Advisory Group (EFRAG), but also in comment letters in the consultation process of developing the standard as well as academic reports and research (European Commission 2008).

The starting-point of the effect study is the ambition that the standard should not lead to increased costs for preparers; nevertheless, this is a key issue that was raised by various interest groups. For example, a much more detailed requirement of accounting for so-called "contingent considerations", meaning the terms for the payment that will be made if some specified future events occur and conditions are met. According to IFRS 3 this is required to be accounted for at fair value at the date of the acquisition, and accounted for separately in the accounts of the acquiring entity, entailing a great deal of work to identify what are actually to be seen as "genuine" contingent considerations. However, the standard setter argues that the increased information value to users of information makes the increased costs for preparers reasonable, and that the increased costs in that sense will be outweighed by the benefits from a user perspective. Also, costs in other aspects of the acquisition would be expected to be reduced compared to the previous standard, for example by removing the requirement to measure assets and liabilities in a step acquisition separately but valuing goodwill at the date control is achieved. EFRAG (ibid., p. 10) has raised the issue that external valuation experts will likely be used in the valuation process as a result of the new standard. That would mean not only that more people will be involved in the process, but also that it will lead to increased costs for the preparers. Also, there will be additional costs to comply with new disclosure requirements. However, comparability between companies was expected to be enhanced, along with transparency from the users' perspective.

The European Accounting Association (EAA 2005) also expressed their opinions on IFRS 3 in a comment letter. The EAA departs from the debate surrounding goodwill accounting and especially the use of fair values. Now, when the whole balance sheet is to be accounted for using fair value measurement at the time of acquisition, there are additional issues that must be discussed. EAA raises the question of whether there is support in the academic literature that a connection exists between values of individual assets and liabilities and the acquisition price. EAA refers to studies about the evidence of poor performance after an acquisition and the literature on the difficulty of estimating returns after an acquisition, even though there supposedly should be value gains as a result of business combinations (cf. Risberg 2013). The EAA (2005, p. 2) also states that "the existing literature does not preclude the recognition of assets at fair value in business combinations".

The EAA then goes on to discuss the issue of valuation of intangibles. They conclude that this issue has attracted a great deal of attention in academic literature because of its increased importance. They say that some studies have found problems regarding reliability, even though fair value accounting for intangibles is still an improvement and more relevant as a measure in relation to historical cost measures. They refer to the concept of "Fudged Accounting Theory" used by Ong (2003) from Murphy (1990) in explaining the variety of reporting alternatives in accounting for intangible assets. Ong (2003) describes many different approaches that companies can take to the value of intangibles. The conclusion is, according to the EAA, that fair value is a useful measure of intangible assets in business combinations, even though the relevance may be lower than for other assets. The

EAA also concludes that it would be better to allocate more of the fair value to goodwill than to individual assets.

Regarding how IFRS 3 affects comparability the effects are yet to be seen. However, from the discussion above, we can conclude that using a fair value approach to goodwill and individual assets and liabilities as well as intangible assets has the potential to create a more uniform approach in term of formal accounting regulation. At the same time it is interesting to note that there appear to be differences in the practical approaches to the valuation of intangibles, and there also seem to be difficulties experienced by accountants in the valuation process. For comparability to be achieved, these difficulties and diversities also have to be dealt with in some way.

3.5 Financial Instruments: Classification and Measurement

3.5.1 Background

One of the most intensively debated accounting standards that have been developed in the process of international accounting harmonisation is the standard for financial instruments. The convergence project between the FASB and the IASB has been difficult, and it has not succeeded in the way that was intended when they first started to collaborate. The FASB and the IASB had both identified financial instruments as a critical area for standard setting, and the two standard setters had a joint meeting in 2005 where accounting for financial instruments was discussed as part of the overall convergence project between US GAAP and IFRS. At this meeting they could agree on three long-term objectives in their work: to develop a new standard for the de-recognition of financial instruments, to require financial instruments to be measured at fair value with realized and unrealized gains and losses recognized in the period they occur, and thirdly to simplify or eliminate the requirements surrounding hedge accounting (FASB 2014). The agreement included, for example, a viewpoint that favoured extensive use of fair values with regard to financial instruments, even though there was also an awareness that a full fair value accounting position was not achievable and probably not even desirable. After a long period of time developing IAS 39 *Financial instruments*: *recognition and measurement*—and also some turbulence with quick changes in the standard in connection to the financial crisis where the illiquid markets created severe problems for banks that were using fair value accounting in their reporting in 2008, a decision was made to replace IAS 39.

The new standard IFRS 9 *Financial instruments* has been developed quite rapidly in several phases in order to eventually replace IAS 39, with the objective of decreasing the complexity of the standard, for example by reducing the number

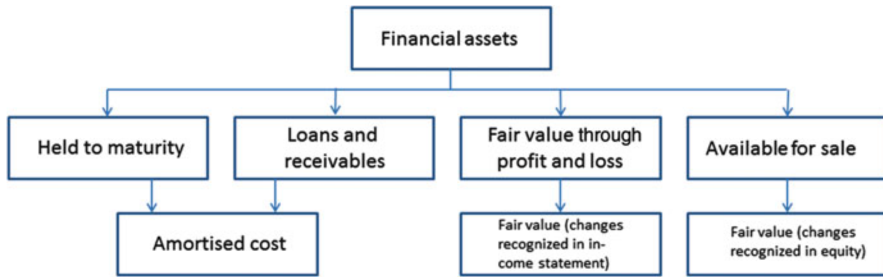

Fig. 3.1 Classification and measurement under IAS 39 (financial assets)

of categories that financial instruments can be classified into (deciding how they then will be measured) and also by adopting a principles-based foundation for the classifications of these instruments. Or in the words of the IFRS foundation (ibid, 2014, p. 2): "IFRS 9 is built on a logical, single classification and measurement approach for financial assets that reflects the business model in which they are managed and their cash flow characteristics."

IAS 39 was issued in 1999 but has been amended several times since then. One particularly interesting feature of IAS 39 with regard to the discussion on uniformity and uniqueness is the way that financial instruments are to be classified. According to IAS 39, these instruments should be classified based on a decision about each transaction and what the purpose of that transaction is. Depending on whether the purpose of the financial instrument (i.e. financial asset) is active trading or not, whether it has fixed or determinable payments or not, and so on, it should be classified in one of the four categories in Fig. 3.1. This in turn decides how the financial asset should be accounted for.

IAS 39 uses four categories to classify financial assets: held to maturity, loans and receivables, fair value through profit and loss, and available for sale. IAS 39 has been criticised for several reasons. One of these reasons has been that the way financial instruments are classified leads to a situation where economically similar instruments have been categorised differently in companies, especially across different countries, leading to less comparability. Because of this, voices were raised to change the basis for classification so that the purpose of each transaction would no longer decide the classification; instead there would be a "business model" approach. This means that in IFRS 9 it is not the purpose of the single instrument but rather the objective of the business model related to the instrument that is to decide the classification.

As has now been highlighted, accounting for financial instruments is a complex and difficult area within accounting. Several researchers have pointed out the degree of subjectivity in the standard. This has been dealt with by also requiring a large amount of disclosure. Looking at the standard of IFRS 13 *Fair value measurement*, those financial instruments recorded at fair value should be classified according to a three-level hierarchy. If the value of the asset or liability is to be based on direct observations of quoted (and thus unadjusted) prices in active

markets for identical assets or liabilities, a level-one valuation is used. In level two, the valuation is based on other types of observable data than those included in level 1 (e.g. quoted prices for similar assets or liabilities). If there are no observable data to be used to derive the value of the asset or liability, a level-three kind of valuation has to be used, where "unobservable" data are used to estimate the value of the asset or liability, such as in the case of complex derivatives or private equity investments.

Much debate has surrounded level-three valuations, and especially the inherent subjectivity in these valuations. This issue is of course a hotter topic in countries, such as the US, with many banks that have a large proportion of their financial assets that must be accounted for using level-three valuation techniques. On the one hand, valuations are often made by external experts using more or less standardised discounted cash-flow models. On the other hand, if there are no observable inputs, more internal information is supposedly used meaning the company itself has a possibility of affecting the basic assumptions of the calculations. One member of the FASB board has called the method "mark-to-management", implying that the valuations in level three are heavily dependent on management's own views. To deal with the growing number of level-three financial assets in the US market for example, SEC has asked companies to provide more extensive information about their valuation procedures. Parallel to this development, the sanctions for wrong-doing and regulatory violations have increased, including both monetary and non-monetary consequences, such as fines and even temporary or permanent suspension from doing business at all.

IAS 39 is a vast and detailed standard that we will not cover in its entirety here. But we will finally mention that it also establishes more uniform hedge accounting criteria for derivatives. There are detailed requirements for when hedging can be used and how it should be used, and the effectiveness of the hedge must also be documented and evaluated regularly.

3.5.2 Tensions and Conflicts Between Uniformity and Uniqueness

IAS 39 was developed as part of the idea of creating a global market, and as an aspiration to reduce the number of alternatives that existed in terms of particular measurement but also recognition and disclosure. As a result the financial instruments that were measured were then not comparable, and there were also a number of financial instruments that could not be recognised, such as derivatives. IAS 39 was thus highly important in creating uniformity in the area of financial assets and liabilities. However, IAS 39 meant not only that a more uniform standard for measurement and recognition of financial assets and liabilities was created, it also meant that the use of fair value accounting increased. From the beginning, when the IASC issued IAS 39 around 2000, the stated long-term objective was that all

financial assets and liabilities were to be accounted for by using fair value measurement. It appears however, that this objective has been modified over the years, especially after the financial crisis of 2007–2008 and the sudden changes in the standard in which some financial assets were allowed to be reclassified out of fair value categories. That was prohibited before the crisis but needed to be done for the sake of economic stability and for reasons relating to the capital adequacy of banks.

It appears that IAS 39 should provide a more uniform approach to financial assets and liabilities. It is also clear that comparability is reached mainly through the idea of transparency and full disclosure of information by recognition requirements and disclosure requirements (IFRS 7 also bears witness to this). In addition, more and more detailed guidance on measurements etc. has been provided in order to also obtain some degree of uniformity in the actual measurement.

One concern regarding fair value accounting in relation to financial instruments is the debate discussed by Laux and Leuz (2009b) about effects of procyclicality, meaning that fair value accounting prompts movements in the financial system, both upward and downward. This can be partly explained by the fact that companies increase their leverage in good times when the value of assets increase, which leads to even greater problems in downturns. It would be interesting for future research to investigate further whether the procyclical effect is something that exists in the operations of a bank and whether such effects are ever part of the basis for strategic decisions in operations or in financial reporting. However, this has also been debated from a transparency perspective; it may be true that financial accounting can affect the behaviours of market participants in a way that emphasises prevailing developments. However, it is difficult to say what the alternative would be—would it for example be better not to provide that information at all, and would that not then lead to a situation of disinformation?

As discussed for example by Ryan (2008), fair value accounting leads to increased volatility in both the income statement and in equity. If we apply this reasoning to a bank, the increased volatility has to be dealt with through the management control system, by enhancing both the extent of certain activities such as hedging, but also control routines such as risk management, and documentation. It is interesting to further reflect on the changes of IAS 39 regarding the financial risk management strategies of banks. Probably, the volatility in income and equity has led companies to think through not only how they apply different accounting standards, but also their use of hedges. With regard to the measurements of fair values, companies have to put considerable work into acquiring the data that is used in the valuation. This data also has to be disclosed and presented in an understandable manner in the annual report. The reporting system must not only work forward to estimate changes in value and effectiveness of hedges, but also be able to trace backward actual effectiveness. Banks need, as a consequence of fair value accounting, both to keep track of the use of financial instruments, and also to keep track of all information needed in order to fulfil disclosure requirements. The increasing size of annual reports from before and after the introduction of IFRS can to a great extent be attributed to the additional disclosures required in IAS 39. These disclosures are not only interesting in that they are detailed and cover many

different areas; they also require the bank to explain how different activities, risks and accounting numbers are connected to each other.

Communication-wise, the fair value standard appears to have entailed a greater need for interaction with stakeholders. For example, Carmona and Trombetta (2008) argue that accounting choices under IFRS must be effectively communicated to stakeholders. These stakeholders might primarily be shareholders, but could also be rating agencies, analysts and other external and internal stakeholders. Internally, it is likely that not only risk management and capital planning would be affected, but also reporting packages and reporting frequencies, given that managers supposedly need to keep a closer watch on markets and risks.

In the academic literature in general, not much is written about the effects on strategies and management control systems resulting from fair values and IAS 39. However, if we look at comment letters written by bankers' associations around the world, for example, several issues can be raised. The American Bankers Association (ABA), for example, submitted three comment letters to the FASB in the middle of 2010 on, among other things, the proposal by FASB that all financial assets be valued at fair value (ABA 2010). The ABA argues that this is a problem relating to the business model and purpose of banks, and says that fair values are only relevant for assets held for trading. Most commercial banks are not involved in selling loans, however, but in granting loans; the business strategy of most banks is to manage customer relationships and customer credits. Trading assets is usually not the main purpose of these banks. Hence, fair values and the logic behind fair value accounting could mean a mismatch with banks' business strategies. Also, the ABA argues, since there is seldom a secondary market for commercial loans, fair values have to be calculated using assumptions and methods that could decrease comparability between banks. Other concerns are that banks will need to implement systems to manage these complex processes of valuation and manage these on a more regular basis. They will also have to be subject to more frequent audits. In summary, there will be additional costs connected with using a full fair value approach.

Chatham et al. (2010), in their overview of issues during the development of IAS 39, mention managerial compensation plans as one of several aspects that can influence an organization's decision to lobby. The authors depart from the remarkable difficulty that has surrounded the development of IAS 39 in gaining broad support for the standard among constituents, where financial organizations and those representing these organizations comprise a large and important part. The IASB (and before that the IASC) has worked since 1988 to develop the standard and has in that time had many difficult questions to address. The article by Chatham et al. (2010) takes up the IASC discussion paper *Accounting for financial assets and financial liabilities* from 1997, which proposes a fair value model for nearly all financial instruments. This discussion paper was particularly interesting since it comprised a major step towards the acceptance of fair value accounting for all financial instruments. The authors analyse comment letters that were received as a response to the discussion paper, and conclude that the issue that received most criticism was the proposal that all financial assets be measured at fair value. This

was something the authors found surprising, given that fair values theoretically should provide better transparency and thus lower the cost of capital. The authors also found it surprising that the countries with mostly positive responses comprised three Scandinavian countries: Norway, Denmark and Sweden. Relatively balanced views were found in Australia, Japan and the US. Other than those countries, European countries were more critical than non-European ones. The reasons for the criticism could to a large extent be traced to organization-specific issues. Some 82 % of those opposing the Exposure Draft put forward the argument that fair values were not consistent with how different financial instruments are managed or used in the business. This suggests, as was also mentioned above, that fair value is a measure that is not necessarily compatible with the strategic orientation or the management control system.

However, the link is complicated, since there is the subjective aspect to managerial information. As discussed by for example Alexander et al. (2012) it could be difficult to see how managerial assumptions in the calculation of fair values could ever be fully objective. This creates an interesting and partly different tension between uniformity and uniqueness in that the same measure could be seen as providing uniformity as a single and uniform accounting model that could be applied to all financial instruments. Unique aspects might then be dealt with by organizations through manipulating or simply interpreting assumptions and calculations in organization-specific ways, ultimately creating comparability problems.

Finally a few words about an area within IAS 39 that has attracted increased attention over the last few decades: hedge accounting. Hedging is a way of managing different kinds of risks, and with a fair value accounting regime, there will be changes in the value of the financial asset or liability that can be dealt with using hedging. From the beginning, hedge accounting was seen as a consequence of the "explosion in financial innovation that has occurred in the last decade" according to DeMarzo and Duffie (1995, p. 743 f). The use of hedging may also in part be explained by the more extensive use of fair value accounting.

IAS 39 states that all derivatives should be accounted for using fair value with changes in value taken through profit and loss. However, since the purpose of the derivative is to offset other changes in value affecting the profit and loss account, the volatility will ideally not be increased by the use of hedges, but rather the contrary. Before the 1990s, disclosures about derivatives and hedges were limited. Not even all derivatives were actually recognised in the balance sheet, since derivatives often do not require any initial investment. During the 1990s the area of hedges attracted more attention among standard setters, and in the US for example guidance was issued in 1995 that required disclosures about derivatives and how they were reported. If derivatives were used for hedging purposes, the intentions and purposes of those hedges had to be described and disclosed. Three years after that there was an additional guideline requiring that all derivatives be recognised on the balance sheet at market value. DeMarzo and Duffie (1995) draw interesting conclusions about managers' motivation to use hedges in an analysis of the information effects of the use of hedges. They argue that managers use hedging not primarily to reduce economic risks, but to reduce what they call accounting

risks, that is, to deal with effects that will appear in the profit and loss account and on the balance sheet. This, they maintain, is in turn connected to what accounting standards and especially disclosure requirements look like; it is what is communicated to shareholders in the financial reports that will decide what will be important for managers in terms of hedging.

3.6 Conclusions and Implications

We have given four examples of financial accounting standards that have attracted a great deal of attention among constituents and are interesting in terms of understanding possible effects of financial accounting and management control, and the interplay between the two information systems. In this chapter and in the discussion of changes in financial accounting standards above, we have tried to capture the possible tensions and conflicts between forces for uniformity in accounting regulation, on the one hand, and forces stemming from uniqueness, on the other.

The chapter described the changes in the reporting of segments where the intention was to change the reporting so that it would mirror the internal decision structure, and the strategy of the company and the potential synergies within the company. The new standard IFRS 8 was issued by the IASB in 2006 and adopted a "management approach", meaning that segments would be reported "through the eyes of management". This meant a convergence with the US standard SFAS 131. It appears that one major benefit of such an explicit integration of the two information systems is that it can be expected to significantly reduce costs. Segment reporting thus constitutes the most illustrative example of a standard that departs almost exclusively from the uniqueness aspect and requires the external reporting to be fully aligned with that. However, criticism was directed against the comparability aspect, since internal and non-IFRS measures would then be used in external reporting. From the perspective of companies, it was not fully clear that the new standard would be beneficial, since it could mean that strategically sensitive information would be shared with the "outside". This in turn would create a situation where management—having a large amount of control over the information being reported—could be tempted to alter this information in order to "hide" sensitive insights about the company's strategies.

Another interesting aspect of the new segment-reporting standard is that after its implementation the number of segments and the volume of information reported have increased. Potentially this can make financial reports more useful to owners and funders, but it can also mean that it will be even more difficult to compare reports from different companies. Their usefulness will depend on how well the information actually helps users understand how segments are related and how internal information is linked to information in traditional financial reports. One conclusion that we draw is thus that accounting regulation directed towards mirroring the uniqueness of a company needs to be thoroughly explained and translated to a more general level. Segment reporting also highlights that

organizations are complex phenomena. The intention of mirroring internal decision-making in external decision-making may be useful and reasonable, but the question is whether it is possible to accomplish that or whether the whole idea is based on an impossible ideal of how organizations work. Decision-making is done by various people and in unpredictable ways, meaning that it is not easily portrayed in external reporting even with the best intentions.

Goodwill accounting, on the other hand, illustrates quite a different example where the driving force stems from the wish to create uniformity by allowing only one kind of accounting method for business combinations, namely the purchase method. The "price" of obtaining that uniformity was paid in the form of allowing companies to test goodwill for annual impairments instead of amortizing goodwill systematically. In that sense, uniformity demands "won" the debate with regard to the method of accounting for business combinations, even in cases where no actual purchase had been made, but rather a pooling of interests. However, the unique aspect of all business combinations can, on the other hand, be dealt with in deciding the assumptions and development of the goodwill item. The purpose is to show the expected future benefit of the acquired entity. However, this leaves management with considerable room to manoeuvre and could create considerable problems in terms of comparability. Just as in the case of segment reporting, the possible problems of internal and organization-specific data, assumptions and calculations are dealt with requiring a large amount of disclosures. Two examples are what circumstances caused the impairment, and how assumptions were arrived at. A sensitivity analysis should also be disclosed to show what would happen to goodwill if some of the assumptions should change. In an analysis conducted by ESMA, the disclosures of companies turned out to be rather standardised in format rather than to provide actual organization-specific information. This, in combination with the finding that goodwill did not always appear to be aligned with economic reality, especially not in more difficult times, creates a problem of both mirroring organization-specific aspects and at the same time achieving comparability. In other words, transparency is not achieved either in terms of enabling comparisons of one company with another, or in terms of understanding one specific entity.

The final two examples highlight some challenges of fair value accounting. The first example is related to the allocation of a purchase price, and revolves in particular around the difficulty of measuring intangibles at fair value. But the example also shows that the use of fair values might change the way acquisitions are done, for example by requiring more experts and independent valuation experts, resulting in higher administrative costs. On a more general level, a large amount of guidance regarding exactly how fair values should be measured will be required in order to achieve comparability, especially since research has concluded that there is a wide range of methods for measuring intangibles at fair value. The question might also come down to how much is allocated to intangibles and how much is allocated to goodwill. The last example is the use of fair value in accounting for financial instruments. In this example, the relevance aspect is an important argument, since standard setters to an increased extent have come to see fair values of financial assets and liabilities almost as an ideal. At the same time, companies do use the

relevance aspect but in relation to business strategy, where they argue that it does not make sense to account for financial instruments at fair value that are not used and intended for trading. With assets that only have a secondary market, or no market at all, fair value measurement becomes a major problem involving comparability problems. As in the cases above, disclosures are critical to achieving transparency. Also, the use of fair value of derivatives used for hedging, for example, requires not only a great many disclosures but also numerous administrative routines for both planning and evaluating the effectiveness of the hedge. Fair value measurement of for example financial assets also highlights the need to implement new information systems in an organization, not only for valuation, and the collecting of data for that purpose, but also for planning, managing and evaluating risk management strategies in relation to financial instruments.

The examples from the development of current accounting standards show that the forces from both financial accounting and management control may be much stronger than has previously been described in the literature. In the chapter, we brought up segment reporting, which creates a strong link between external and internal reporting. In this sense, there is a need to integrate the two information systems. In this example, the "relevance" aspect is connected to what is considered relevant internally—relevance is to mirror the internal decision-making. However, in other cases, such as with financial instruments, the relevance aspect is connected to the financial markets and the alignment of reporting with the most current and generally accepted value of similar assets. According to some researchers, what gets lost instead is the "internal relevance" aspect; banks complain that the fair value regime creates a mismatch between the intentions the banks have for the assets, how the assets are managed internally, and the way the assets are reported.

One important aspect of the interplay between financial accounting, on the one hand, and management control systems, on the other, is to consider whether the financial reporting standards are rule-based or principles-based. If externally imposed standards are strictly rule-based without any room for judgements and interpretations, the management control system in the company is likely to be affected extensively when the financial accounting standard is adopted. This in turn has consequences for key aspects of the management control system, such as strategic planning and budgeting. Since strategy and management control must be in line with each other, this could in turn lead to long-term problems with regard to the fit between the management control system and the strategy of the company. In cases where financial accounting standards are more principles-based, leaving room for judgements, the management control system can have a much stronger effect on the outcome of financial accounting numbers than has been acknowledged earlier. In previous literature, the role of earnings manipulation has often been described as the main reason for judgements being the cause of differences in financial accounting regulation. However, we argue that the reasons that judgements lead to differences in financial accounting numbers are much more complex; they are not only related to opportunism on the part of individuals, but to the coexistence of deeply rooted components of the management control system. Because of their inherent connection to the company's strategy, accounting standards that leave room for

such an effect can affect external financial reporting. Perhaps even more importantly, it seems as if the tensions and conflicts between financial accounting and management control may in fact be necessary and perhaps also beneficial to companies, leading to questions regarding the general ideal of total transparency. Even in cases where external regulators want the company to use internal information in the external reporting (something that would minimise costs for the company), companies often seem to be reluctant to do so since they do not want to reveal all essential strategic information about their operations.

Chapter 4
How Financial Accounting Affects Management Control

4.1 Introduction

Chapter 3 presented four examples of financial accounting standards that have had a great deal of impact on financial reporting: segment reporting, goodwill accounting, business combinations and financial instruments. By analysing the background to why these new standards were issued—and how regulators, practitioners and researchers discussed possible consequences of the standards being implemented—some possible tensions and conflicts between demands for uniformity and uniqueness could be identified. Some of these tensions and conflicts could be related to the question of whether the strive for uniform, comparable and transparent financial reports affect strategies and control systems in such a way as to make them less relevant for internal decision-making. In other words, do the new accounting standards not only "mirror" what the company has achieved but also affect the management and development of the company? Or are these standards, based on a new accounting regime, also suitable for making strategic, tactical and operational decisions, perhaps even contributing to making the management control systems more relevant?

In this chapter we discuss tentative answers to these questions. By doing so we lay the foundation for the closing discussion in Chap. 5, which focuses on the identified tensions and conflicts between financial accounting and management control and whether the tensions and conflicts are possible or even desirable to resolve. But first we need to extend and deepen the analysis of how the four regulations discussed in Chap. 3 can be expected to affect strategies and control systems. By reasoning based on our knowledge and experience, and using results from our literature review, we discuss possible effects of financial accounting regulation on management control design and use. We base or analysis on the division of management control into strategic planning, budgeting, reporting and analysis and, finally, rewards and compensation. How these different categories of the management control process can be affected by financial accounting is

© Springer International Publishing Switzerland 2015

F. Nilsson, A.-K. Stockenstrand, *Financial Accounting and Management Control*,
Contributions to Management Science, DOI 10.1007/978-3-319-13782-7_4

Fig. 4.1 The management control process. Similar figures have been published by for example Anthony et al. (1989, p. 27)

discussed by using the examples in Chap. 3 (i.e. segment reporting, goodwill accounting, business combinations and financial instruments). Thus, the main difference between the structure of Chap. 3 and this chapter is that the former is organized from the perspective of demands for uniformity and the latter from the demands of uniqueness.

Figure 4.1 illustrates the process view of management control that we apply in this chapter. That view emphasizes strategy formulation (i.e. strategic planning and budgeting) and strategy implementation (i.e. reporting and analysis and rewards and compensation). It is illustrated as a continuous process in which strategies and control systems affect one another in a double-loop learning manner. It is fair to say that this illustration of the management control process is very well established and often used in textbooks throughout the world (see for example Anthony et al. 1989). It should be noted, however, that in some late research the concept of management control has been broadened to also include cultural and administrative controls (see for example Malmi and Brown 2008). In this book, and as mentioned earlier, we will not discuss these two types of controls due to the risk of making the discussion too broad and shallow.

The remainder of the chapter is organized as follows. We will start with strategic planning and then move on to the later stages of the control process (i.e. budgeting, reporting and analysis and rewards and compensation). As mentioned, for each of these four categories of the management control system we will discuss how they can be affected by financial accounting and also the other way around. The chapter will end with conclusions and implications.

4.2 Strategic Planning

Strategy formulation and strategic planning are often analytically separated in the literature. Anthony and Govindarajan (2004, p. 349) formulate the distinction in the following way:

> Strategy formulation is the process of deciding on new strategies, whereas strategic planning is the process of deciding how to implement the strategies. In the strategy formulation process, management arrives at the goals of the organization and creates the main strategies for achieving those goals. The strategic planning process then takes the goals and strategies as given and develops programs that will carry out the strategies and achieve the goals efficiently and effectively.

According to Anthony et al. (2014) strategic formulation is characterized as an informal process that is unstructured, creative and innovative. Strategic planning is characterized as a formal process that is structured in distinct activities and has a tendency to become institutionalized. Even though these differences can be identified and discussed on a conceptual level—in practice, the boundary between strategy formulation and strategic planning is fuzzy (ibid., p. 349 f). One of the reasons for that is the strong tendency for realized strategies to be a result of both intended strategies (planned activities) and emergent strategies (a consistent but unplanned pattern of activities) (Mintzberg 2000, p. 23 ff.). Arguably it is reasonable to assume that most strategies that are successfully implemented are the result of both intended plans and emergent ideas and activities. Another reason is that management control systems are designed and used both for formulating and implementing strategies (Simons 1995). Research has shown the importance of management control information in changing, as well as developing new, strategies (see for example, Ahrens and Chapman 2007; Jørgensen and Messner 2010; Cuganesan et al. 2012). Thus, in conclusion it seems difficult to separate the informal and formal strategy processes. We will therefore include activities of strategy formulation when discussing strategic planning and its relationship to financial accounting.

In the following sub-sections we will discuss how changes in four accounting standards can be expected to affect strategic planning. We know that information from the company's control systems is very powerful in directing, and re-directing, the attention of managers and employees (cf. Ocasio 1997; Ocasio and Joseph 2008). The company and its environment (e.g. competitors, customers and suppliers) can be expected to be analysed based on information that is provided through the management control system (Shank and Govindarajan 1993). The control system then becomes a filter of information at the same time that it is used as an important basis for making strategic decisions (Simons 1995). We also know, from the discussion in earlier chapters, that the most successful companies have aligned their control systems (including the strategic planning process) to the environment and the strategies pursued (for an overview see Jannesson et al. 2014).

The question that we will try to answer in the following sub-sections is whether the alignment of the management control system can be disrupted by changes in

accounting standards or whether such changes will perhaps even improve the alignment. The rational for that question is that financial accounting, in a fashion similar to management control, affects the attention of senior executives (see for example Johnson and Kaplan 1987): how the value creation of the company will be evaluated in the financial reports will most probably affect, both directly and indirectly, strategic planning. In the following sections we will discuss the possible effects of such a change in senior executive attention more in detail.

4.2.1 Segment Reporting and Effects on Strategic Planning

Accounting standards are based on a logic in which there is a strong congruence between the goals of the principals (owners and funders) and the agents (board and senior executives). As a result of this congruence, at least in principle, there should be no significant differences regarding the information needs of owners and managers (Ewert and Wagenhofer 2007). This logic is especially evident in IFRS 8 *Operating segments*, issued by IASB in 2006. As described in Chap. 3 the performance of a company's segments should be reported externally in the same way it is reported internally, or in other words, "through the eyes of management". The guiding principle is that the same information that the "Chief Operating Decision Maker" (CODM) uses for allocating resources internally should also be used in the financial reports. The idea is that external stakeholders should be provided with the same information about strategies and their risks as managers and employees. The expectation of the regulation was that it would improve decision-making by reducing information asymmetries between principals and agents. Another expectation is that it would increase the integration between financial accounting and management control and by doing so decrease the costs of providing accounting and control information. Actually there is probably no other accounting standard that is more suitable than IFRS 8 for achieving integration (cf. Taipaleenmäki and Ikäheimo 2013).

If we look more closely at the possible effects of this accounting standard on strategic planning, we can first of all conclude that the aim is to increase the alignment of how the strategies of the company are described and reported in the annual report and in internal reports. For example, if segments are reported based upon product lines, it will be easy to scrutinize the business strategies that the company is pursuing and which corporate strategy is most suitable. That transparency will probably expose the strategies and also put them in focus. This will also give the owners and other stakeholders an opportunity to have an opinion about the strategies as well as engage in a discussion with senior management on the future direction of the company. There will also be a clear link between strategic planning and the success of the strategies formulated (we will discuss performance evaluation in more detail in Sects. 4.4 and 4.5). As a consequence of these probable effects, it is reasonable to expect that senior management will put more effort into improving and fine-tuning the strategic planning process with the ultimate goal of formulating strategies that further increase the competitiveness of the company.

Implicitly, these types of effects, of a better alignment of external reporting and strategic planning, are also expected in frameworks such as the corporate responsibilities continuum (Bhimani and Soonawalla 2005) and integrated reporting (IIRC 2013).

Even though strategies are long-term and can be difficult to describe in the more or less standardized format of a typical annual report, it must be advantageous for the development of the company, at least in most cases, for such information to be submitted to the principal stakeholders. Of course some stakeholders could represent a short-sighted view of the company and its development, but this could hardly be a reason for not increasing transparency, since it would imply that the owners and funders would have to be protected from their own preferences and long-term goals. A more difficult problem, discussed in Chap. 3, could be that sensitive information would be made available to competitors and that such a risk might be avoided by changing the internal reporting and hence the segments into something that is not aligned with strategies. As pointed out by Nichols et al. (2013) senior executives have considerable freedom to decide how to report company segments. Any development in which segment reporting is not reflecting internal decision-making, for whatever reason, is negative, and there are some indications that this type of problem exists. The extent of the problem is difficult to assess, but we assume that it is not especially widespread, since the profit margins and risks for different product lines can be expected to be known among industry experts. Finally, there is also the problem of a lower comparability between companies within the same industry, which could make the evaluation of the strategies pursued more difficult (cf. Paul and Largay 2005). But to use standardized and IFRS-compliant performance measures instead is even worse, since that would make it probable that these measures would eventually invade the management control system and make it less aligned with the strategies being pursued.

In conclusion we would argue that this accounting standard has the potential to improve the strategic planning process by aligning the reporting of strategies to how they are formulated. The risk of exposing the strategies to competitors and short-term-oriented owners and the disadvantage of a lower degree of comparability between companies must be compared to what can be gained by having a more informed discussion and analysis of the strategies both outside and inside the company. To us it seems as though the changes in segment reporting can have positive effects on the design and use of strategic planning, even though there are some possible disadvantages.

4.2.2 Goodwill Accounting and Effects on Strategic Planning

Accounting for goodwill has always been an area of discussion and controversy. The reason is that a decision to merge with another company, or to acquire it, is very often of fundamental strategic importance (cf. Nilsson et al. 2013). In the literature there are many examples of mergers and acquisitions that have resulted in

significant changes in both the income statements and balance sheets of the merging companies, sometimes in a negative way (cf. Anderson et al. 2013). Since these decisions can have very noticeable effects on the financial accounts, it is not surprising that practitioners and scholars alike have paid a lot of attention to goodwill accounting. As described in Chap. 3 these discussions, among practitioners and scholars, have resulted in several new accounting standards. In this subsection we will focus on IAS 36 *Impairment of assets*, in which it is stated that goodwill should no longer be amortized. Instead impairment testing should be used to decide whether a write-down of goodwill is necessary or not.

The strategic importance of mergers and acquisitions makes impairment testing a very interesting area to discuss, especially in terms of how it affects strategic planning. If we start by looking at the planning process itself, there are several activities that can be expected to change as a result of impairment testing relying on forward-looking information. Since the financial effects of the merger or acquisition are dependent on the results of future impairment tests, the board and senior executives must be diligent when making their strategic plans. Taipaleenmäki and Ikäheimo (2013) identify two activities that are especially important in this connection: (1) the due diligence process, which has the potential to identify risks and other circumstances that can affect the long-term cash-generating capacity of the target company; and (2) improved processes and routines for evaluating the cash-generating capacity for the acquired company on an continuous basis. Both these activities are forward-looking, but since the latter is an on-going activity, it must be integrated with the planning and follow-up routines in the management control system.

At a more detailed level, and based on the more general reasoning of Taipaleenmäki and Ikäheimo (2013), it is reasonable to expect that the strategic planning of mergers and acquisitions will place considerable emphasis on: (1) the business case and its key assumptions (such as risk and discount rate), ensuring that they are reasonably correct; (2) the sensitivity analysis and how different business scenarios (including changing growth rates) will affect the cash-generating capacity. However, a report by ESMA (2013), which we described in Chap. 3, shows that many companies did not disclose information about these areas in the annual report and/or did so in a rather inconsistent manner. As discussed above, this creates problems for stakeholders outside the company to evaluate the acquisition strategies of the company. It could also be an indication that necessary changes to the strategic planning process are not being carried out. Especially the latter form of problem is more severe, since it is well known in the literature that the quality of the strategic planning process is instrumental for carrying out a successful integration of the acquirer and the target (see for example, Jemison and Sitkin 1986).

It is also interesting to reflect on the possibility that impairment tests will affect not only the strategic planning process itself but also merger and acquisition strategies. That type of analysis is not easy to perform and runs the risk of being rather speculative. However, it is reasonable to expect that there will be some direct and indirect effects. The direct effects could be related to the difference between amortized goodwill and an impairment test. The former comes with few surprises—

the board and senior executives know with some certainty how the merger or acquisition will affect the income statement and balance sheet. The latter is less predictable, but at the same time there is the possibility of no write-down at all. Depending on the risk appetite of the board and senior executives, this could be expected to affect the strategies. However, it is not self-evident that impairment testing will lead to less risky mergers and acquisitions; it could also be the other way round. The indirect effects are even more difficult to analyse, since they are related to changes in the process itself. Most probably improved strategic planning will lead to more informed decisions in which the risks and opportunities of possible strategies are made more transparent. Even so, to go ahead with a merger or an acquisition will always be a very difficult and risky decision.

In conclusion, the introduction of impairment tests in accounting for goodwill has the potential to lead to an improved strategic planning process. The necessity of creating routines for evaluating future cash flows from the acquired unit is of course a challenge. According to Taipaleenmäki and Ikäheimo (2013) it will require that future-oriented information is captured, analysed and distributed within the management control system. Examples of that type of information are how markets develop, changing customer preferences, the cost structures of competitors etc., in other words information that is important for making long-term strategic decisions. In the research area of strategic management accounting (SMA) (Langfield-Smith 2008) this type of external and forward-looking information is considered very important, and the introduction of new IT systems has made it easier to build control systems with such an orientation (Rom and Rohde 2007). Another challenge is to ensure that the planning process is enhanced and aligned to the requirements following the standard. As mentioned earlier there are some indications that the changes will not be fully implemented. If that is the case, and especially since mergers and acquisitions are strategic activities, it is not unreasonable to expect that both public authorized accountants and internal auditors would have an opinion about the state of the matter (cf. Nilsson et al. 2013).

4.2.3 Business Combinations and Effects on Strategic Planning

Accounting for business combinations is closely connected to goodwill accounting and therefore the possible effects on strategic planning will be somewhat similar. In this sub-section we will analyse the effects of IFRS 3 *Business combinations*. As described in Chap. 3 this standard was a further development of IAS 22 *Business combinations*. According to the new standard, the pooling of interests method could no longer be used, and a company that is acquired should have its assets and liabilities valued at fair value on the transaction day (i.e. when the acquirer obtains control over the acquired company). Intangible assets and contingent liabilities

should also be identified and valued following the same principles. They should also be accounted for separately, which can be difficult to do, since the buying company is dependent on information provided by the target company. With this short summary as a back-drop, we will now look more closely at how fair value accounting in mergers and acquisitions can be expected to affect strategic planning and also touch upon the effects on eliminating the pooling of interests method.

Starting with the strategic planning process itself we can expect that fair value accounting will lead to a complicated evaluation of a possible merger or acquisition. The simple reason is that the valuation of assets, liabilities and goodwill can have significant effects on the reported financial performance of the acquired company. As mentioned in Chap. 3, it will be a major challenge to make this valutaion, and most probably the acquiring company will be more dependent on outside valuation experts. So-called contingent considerations should also be identified and valued following the same principles. Hence, the valuation process, including the due diligence process, will be affected and made more complicated as well as more costly. On the other hand, this is not necessarily a bad thing if the benefits outweigh the costs. One such benefit is that the changes to the valuation process could also be expected to lead to a more transparent strategic planning process. The board and senior executives will be forced to go into even more detail regarding how assets, liabilities and goodwill are (and should be) valued. A more informed discussion of the strategies being pursued is an advantage and in line with the type of interactive control systems that Simons (1995) considers important in the formulation of new strategies. This is a welcome possible improvement of the strategic planning process. As mentioned, it is well known in the literature that the quality of the process in general (Mintzberg 2000), and especially in connection to mergers and acquisitions (Jemison and Sitkin 1986), can be questioned.

Moving on to the level of strategies being pursued, it is more difficult to analyse possible effects. As a result of increased importance of fair value accounting financial reports will be more transparent and the effect of bad decisions will probably be made visible more quickly (cf. Barlev and Haddad 2003; Hemmer and Labro 2008). According to Barlev and Haddad, fair value accounting will reduce the information asymmetries between principals and agents, leading to higher value relevance in financial reports and enhanced stewardship. As a result the board and senior executives could be expected to improve the strategic planning process itself as well as scrutinize and justify their merger and acquisition strategies. It is possible that as a result there will be fewer mergers and acquisitions on the margin. In that connection we should also say a few words about the elimination of the pooling method. This change took away an accounting method that was used in order to avoid having to account for goodwill. A probable effect is that it changed the merger and acquisition strategies of some companies. On the other hand, a merger is usually only made once and is not a recurrent phenomenon for most companies. Therefore the effects on long-term strategies for most companies are not self-evident.

In conclusion the importance attached to fair values in connection with mergers and acquisitions will make strategic planning more complicated and demanding. At the same time the process will be more transparent and probably lead to improved analysis and better strategic decisions in the end. Fair values and impairment testing will also require more future-oriented information, some of which is financial, some non-financial. Planning will certainly involve senior executives (as well as outside experts) even more and be centralized to a larger extent. We also expect the design and use of the planning process to be changed, and in some cases these changes will be in line with the corporate and business strategies being pursued. In some cases the changes can result in a temporary misalignment that can eventually be restored as a result of changes in the corporate and business strategies. In either case we believe that the tensions and conflicts that we have identified are not especially serious and that the changes in financial accounting also bring many benefits that will improve strategic planning in the end.

4.2.4 Financial Instruments and Effects on Strategic Planning

Accounting for financial instruments is without doubt a complicated area, and it has been widely debated. This is also an area in which the market-based orientation of financial accounting is most visible (cf. Miller and Power 2013). Based on research from financial economics, in which security prices are in focus, regulators have been influenced and convinced that a market valuation of financial instruments improves the value relevance of financial reports. This conviction eventually led to the launch of the standard IAS 39 *Financial instruments: Recognition and measurement*, as described in Chap. 3. However, the practical difficulties in the application of IAS 39 forced the IASB to prepare a new standard that will replace IAS 39: IFRS 9 *Financial instruments*. In IFRS 9 the instruments should be classified according to the business model of the company or part of the company. Since accounting for financial instruments has been discussed exhaustively, not least because of the financial crisis in 2007–2008 that affected many banks and other financial institutions, there are papers published discussing the effects of fair value accounting. Some of these papers are discussed in Chap. 3, so we will not repeat their contributions here. Nevertheless, the insights gained from them are important when analysing how financial instruments affect strategic planning.

Even though accounting for financial instruments has been extensively discussed and debated, it is worth remembering that many companies do not use these instruments at all. On the other hand, they are very important in the financial sector and will certainly affect both strategies and control systems in such companies. And since the management of these companies will also affect the overall economy, as well as most other organizations, financial instruments and how they affect strategic

planning are important issues to discuss and analyse. A starting point for such a discussion is that market-based logic, which is the fundamental building block of fair value accounting, will increase the volatility of both income and equity (Ryan 2008). As a result, uncertainty will increase and make long-term planning more challenging, since the effects of the strategic plans will be difficult to foresee and control (cf. Govindarajan 1988). In order to handle the higher level of uncertainty, managers need more forward-looking information to be able to decrease the level of uncertainty. Such information is also a requirement if the instruments are to be valued in an appropriate way. Even though new IT solutions promise a great deal, our explorative interviews indicate that these systems also have limitations regarding what can actually be done (cf. Taipaleenmäki and Ikäheimo 2013). Especially in banks, the IT systems are often old, and there are no guarantees that they can provide management with the requisite information in a cost-effective way (e.g. without manual adjustments). However, since different banks have different strategies, or even several different strategies within the organization as a whole, this information will also be managed in different ways. With the introduction of a business model approach in IFRS 9, we believe financial institutions in particular will become more focused on their business models, and also more consciously focus on how to manage different strategies and the planning of those strategies.

Turning to the increased level of uncertainty, this is also related to risk management, which is an important process closely related to both long-term and short-term planning (IAA 2007). As discussed by Mikes (2009, 2011), Wahlström (2009) and Arwinge (2014) the risk management process in the financial industry is a core activity affected by regulations and closely connected to strategic, tactical and operational decision-making. Since financial instruments affect both the business and how it is reported, risk managers must be closely involved in how these instruments are used and accounted for. Even though Mikes, Wahlström and Arwinge do not explicitly discuss the effect of IAS 39, they nevertheless underline the importance of risk management processes being designed and used in a way that is aligned with the strategies being pursued. Hence, it can be expected that risk management processes in the financial industry have been changed to handle the increased level of uncertainty in strategic planning. An interesting result from their research is that their data indicate that financial institutions seem to be able to balance demands for uniformity (such as Basel 11) and demands for uniqueness (such as a decentralized risk management practice). Finally, it is also worth noting that hedge accounting can be used to offset changes in the values of certain financial instruments and by doing so contribute to managing accounting risks (DeMarzo and Duffie 1995).

At the level of strategy it is important that those financial instruments that the company uses for trading are valued at market price to ensure alignment with the business model and strategy pursued (ABA 2010). Fair value accounting could also make it more difficult to communicate the strategies inside the company. Our explorative interviews indicate that since accounting for financial instruments is so complicated, a great deal of effort, even at the board level, is needed to analyse

and explain the underlying result and whether it is in line with the strategies being pursued. The same reasoning could be applied to the outside communication of the strategies (cf. Carmona and Trombetta 2008). Even though the sections of annual reports describing accounting for financial instruments are much longer and more detailed than they used to be, it could be questioned whether the level of transparency has increased. If that is not the case, this could be detrimental to an informed discussion about the strategic orientation, both inside and outside, the company.

In conclusion it is reasonable to argue, along the same lines as Hemmer and Labro (2008) that fair values have high decision relevance for both owners and managers in the financial industry. According to the authors they reflect reality and make it more difficult to hide poor performance. They also argue that fair values will contribute to a better alignment between financial accounting, management control and risk management. On the other hand, the complexity of financial instruments will demand a great deal from the user of accounting information. Fair values will also increase uncertainty and make planning more difficult. Efforts to deal with this could include more forward-looking information, improved integration of the planning process and risk management and use of hedge accounting. Strategies could also be changed to avoid certain types of financial instruments. There is of course also the possibility of trying to de-couple financial accounting and strategic planning, accepting that the short-term results would be difficult to evaluate in relation to the long-term objectives of the strategies.

4.3 Budgeting

A budget is a plan covering 1 year and expressed in financial terms. It is closely linked to the strategic planning process and the processes of reporting and analysis as well as rewards and compensation (cf. Fig. 4.1). Anthony and Govindarajan (2004, p. 410) formulate the distinction between budgeting and strategic planning in the following way:

> Both strategic planning and budget preparation involve planning, but the types of planning activities are different in the two processes. The budgeting process focuses on a single year, whereas strategic planning focuses on activities that extend over a period of several years. Strategic planning precedes budgeting and provides the framework within which the annual budget is developed... Another difference between a strategic plan and a budget is that the former is essentially structured by product lines or other programs, while the latter is structured by responsibility centers.

In the budget process the strategic plans will become more concrete and detailed. How strategies will affect income, costs, performance, investments etc. must be specified in the budget. Since the budget is used for short-term planning and evaluation of performance in relation to the plans, it is an important management control activity in many companies. That is also the reason why the advantages and disadvantages of budgeting have been discussed extensively, both among practitioners and researchers (Anthony et al. 2014). There are critics who argue that a

budget is an obsolete planning tool because of the difficulty in making plans in a fast-changing environment (see for example, Wallander 1999; Hope and Fraser 2003). Researchers using contingency theory take almost the opposite position, arguing that the suitability of using budgeting is dependent on the strategies being pursued (for an overview of quantitative contingency research, see Langfield-Smith 2007). For reasons presented in earlier chapters we adhere to the view of contingency theorists.

In the following sub-sections we will discuss how changes in financial accounting can be expected to influence the design and use of budgeting. We will apply the following, rather broad, definition of budgeting: a 1-year economic plan expressed in financial terms that could be related to both the strategic plan as well as the income statement (cf. Anthony and Govindarajan 2004, p. 409). We do not consider models such as the Balanced Scorecard (Kaplan and Norton 1992) to be budgets, even though we acknowledge that they can be a useful addition in the planning and follow-up routines and processes (cf. Malmi and Brown 2008). Furthermore, we will use the same four accounting standards that were analysed in the previous sub-section. Since strategic planning and budgeting are closely related, some overlapping will be difficult to avoid. At the same time budgeting is likely to be more closely related to financial accounting, since it follows the same 1-year cycle as the financial reports. In that respect budgeting is an important tool for directing short-term attention and efforts to areas that will be reported in the annual report. The following sections will for that reason be more focused on how changes in the standards are expected to affect short-term activities as expressed in the 1-year budget. In line with the analysis in the former sub-sections we will focus on the overall question of how these changes affect the alignment of budgeting to the strategies pursued.

4.3.1 Segment Reporting and Effects on Budgeting

In most companies the budget serves as the link between strategic planning and the reporting and evaluation of these plans. For this reason it can be expected that changes in how performance of company segments are reported to outside stakeholders will affect budget design and use. The requirement in IFRS 8 *Operating segments*, that segment reporting should mirror how decisions are made internally, is a strong driving force for companies to integrate their planning and follow-up systems (cf. Taipaleenmäki and Ikäheimo 2013). Here we assume, for reasons of simplicity, that the company will not make any changes to their segments in order to avoid reporting sensitive information to competitors. That this is not necessarily always the case is discussed in Chap. 3 as well as in the section on segment reporting and its effects on strategic planning.

We have already discussed how IFRS 8 will most probably result in strategic planning being aligned to how segments are reported and evaluated by outside stakeholders (e.g. owners, funders and analysts). In addition there is a strong

tendency that strategies should be reported and evaluated in relation to how companies perform in both financial and non-financial terms (see for example IIRC 2013). Therefore there will be strong incentives for management to ensure that the management control process described in Fig. 4.1 is well designed and used. It is especially important that strategic plans, which sometimes are rather imprecise (see for example Mintzberg 2000), will become more concrete, specified and possible to follow up in detail. As described above, that is precisely the objective of the budgeting process.

Even though the alignment of budgeting to segment reporting has the potential to enhance transparency and to make decision-making more focused on how results are reported outside the company, there are also some possible drawbacks. First of all there is a risk that a strong alignment can lead to a situation in which outside demands from external stakeholders will be applied uncritically in the budgeting process. According to Taipaleenmäki and Ikäheimo (2013) such a situation could create considerable frustration inside the company, since management realizes, having access to more detailed information, that these demands—for example an improved profit margin—would be very difficult to achieve. The authors (ibid.) even speculate that the pressure from external stakeholders could be so strong that earnings management and even fraud is a possible outcome.

Second, and related to the influence of external stakeholders, the budgeting process in itself can be affected in a way that makes it less aligned to the strategies pursued. Since segment reporting will in most cases be oriented towards short-term financial information, this kind of focus can also take on a dominant influence not only in strategic planning but also in the budgeting process (cf. Törnqvist 1999). Such a focus is in line with, and even beneficial to, a situation in which the company follows a portfolio management strategy combined with a cost-leadership orientation at the business unit level. However, if the company is pursuing an activity-sharing strategy combined with a differentiation strategy, the budget process should ideally have a loose and long-term character and use a great deal of non-financial information (cf. Jannesson et al. 2014). In the latter case a strong alignment to outside demands for short-term financial results could have unintended consequences, such as affecting the management control system in a way that makes it less adapted to the unique situation (i.e. the strategy).

Third, the enhanced link between financial information presented in segment reports and budgeting could also affect the use of other short-term planning models used as a complement to or a substitute for the budget. These models, some of which we presented in Chap. 2 (e.g. Performance Pyramid, Balanced Scorecard), are designed for aligning strategies to tactical and operational decision-making by using a combination of financial and non-financial information. It is not self-evident how segment reporting will affect the use of these models. One possible development is that they will also be closely aligned to the strategic planning and the follow-up processes. Such an alignment could result in an orientation towards financial information and towards how non-financial information can be more strongly related to value creation as it is reported in the annual report (cf. Donovan et al. 1998).

In conclusion it is reasonable to expect that changes in segment reporting will affect the budgeting processes in many ways. One effect is a stronger alignment between financial accounting and management control. Following increased alignment and increased transparency, demands from the outside can be expected to receive much more attention and focus inside the company. That is not necessarily a bad thing, but we should also be aware of the possibility of unintended consequences—such as management control systems being less adapted to the unique situation of the company. Such effects could be difficult to avoid and even detect. At the same time they can have negative long-term impacts, as shown by for example Johnson and Kaplan (1987).

4.3.2 Goodwill Accounting and Effects on Budgeting

The ultimate aim of budgeting is to ensure a successful implementation of the strategies chosen, such as merger and acquisition strategies (cf. Anthony et al. 2014). Therefore we can expect that IAS 36 *Impairment of assets* will first and foremost affect how the budget is designed and used during and after the integration of the acquired company. At the most fundamental level the requirement to perform annual impairment tests will lead to a situation in which management must collect and analyse forward-looking information. As we have already discussed in the section on strategic planning, this type of information is necessary to be able to evaluate the cash-generating capacity of the acquired company (cf. Taipaleenmäki and Ikäheimo 2013). Since budgeting is almost always based on a 1-year planning horizon, it should be of instrumental importance for evaluating the need for a write-down of goodwill. So what type of changes, if any, could we expect as a result of changes in goodwill accounting and especially the introduction of impairment tests?

First of all the ability to enhance the forward-looking capability of budgets is probably one area of concern. However, as mentioned above, it is well known in the literature that plans such as the budget are very difficult to make, and that is especially the case in turbulent environments (see for example Govindarajan 1988). In that type of environment budget control is often loose and more long-term, recognizing the inherent planning difficulties. The budget is therefore not so important, and instead forward-looking information is focused on how customer preferences are developing, what competitors are doing etc. (Nilsson and Rapp 2005)—in other words information that is captured outside the formal budgeting process. As discussed earlier the introduction of new IT systems makes it easier to use this type of information in the formal management control system (Rom and Rohde 2007). Models such as the Balanced Scorecard are one possible solution that could be a useful addition to the budget, orienting it more towards forward-looking information. Finally rolling forecasts are a solution that is often used in more turbulent environments. Instead of making a very detailed budget for the whole year, the planning resources are used instead for making a new prognosis each

month (see for example Olve 2014). By doing this, it is possible to increase the accuracy of the plans being made, which would also be beneficial as input to an impairment test.

Second, there could also be effects at the acquired company. In order to increase transparency and control over the acquired company, changes to the budgeting process in that company could be enforced. By implementing the budgeting routines of the acquiring company in the acquired company, group management can ensure that the strategy for the acquisition is implemented by strengthening the coordination of important activities. They will also be in a better position to design both the planning and the follow-up routines in such a way that they can be more involved in the management of the newly acquired company. By doing so they can ensure that synergies are realized not only to avoid a write-down of goodwill but also to identify much more quickly whether a write-down is necessary. On the other hand, a tight alignment of the control systems between the acquiring and the acquired company can also lead to a situation in which the latter suddenly has a management control system that is not entirely suitable to the strategies of that company (see for example Nilsson 2002). The disadvantages of that situation must be compared to the advantages of attaining a higher degree of transparency and control.

We can now conclude that the budget is important for a successful implementation of the merger and acquisition strategy. It is also an important process for collecting and analysing forward-looking information that can be used in the annual impairment test. Even though budgeting is important, we should remember that a large portion of write-downs are a result of the acquiring company paying too much for the target (Olante 2013). In such cases it is only a matter of time before the impairment test will indicate that a write-down of goodwill is necessary. However, the budgeting process, in combination with other types of forward-looking information, can of course help to detect errors made in the negotiation phase much more quickly. Finally, and in line with the conclusions in the section of strategic planning, it is important to acknowledge that the requirements under the new standards do not seem to be fully implemented. It is therefore difficult to know to what extent the standard has affected strategies and control systems.

4.3.3 Business Combinations and Effects on Budgeting

The standard IFRS 3 *Business combinations* states that fair value accounting should be used when accounting for goodwill. As mentioned in other sections the consequence is that the assets and liabilities should be measured at their fair value at the acquisition date. We have also concluded in the previous section that the budget is a short-term planning tool that is foremost designed and used to implement a chosen strategy. Therefore we can expect that IFRS 3 will have effects on tactical decision-making (i.e. decision-making with a timeframe of roughly 1 year). These effects are mainly a result of fair value accounting, which is based on the logic of market

values. Miller and Power (2013) argue that this logic is not necessarily compatible with a managerial decision-making logic. Other researchers believe that there is a strong congruence of goals between the owner and the managers and that the difference between market and managers is therefore not that great (see for example Ewert and Wagenhofer 2007). Even though there seems to be some disagreement on the logics affecting financial accounting and management control, there is little disagreement that fair value accounting will have effects on the control systems.

In the previous sections we have discussed the importance of forward-looking information when using fair value accounting. Measuring the acquired assets and liabilities at fair value on the acquisition date will probably have no significant effects on budgeting in the acquiring company at that point in time. However, and as we have already pointed out, the annual impairment test will require information that could ideally be collected from a formal planning system such as the budget (Taipaleenmäki and Ikäheimo 2013). Especially in a company that makes frequent acquisitions, the budgeting process will probably be adjusted. One example is to have a stronger integration with the follow-up routines in order to truly make sure that the newly acquired company develops in a way that could be expected (see for example Jones 1985a, b) (this will be discussed in more detail in the sections on reporting and analysis as well as rewards and compensation). As pointed out in the literature, a strong control influence over the acquired company is very important in order to realize the strategic plans and budgets for the combined company (cf. Roberts 1990). This will be even more important when a yearly impairment test must be conducted. Another example is that the need for more forward-looking information could trigger changes to collect and analyse that type of information within the framework of the budgeting process. In the preceding sections we also discussed how Balanced Scorecards, rolling forecasts etc. could be used as a complement to budgeting.

In conclusion we can say that IFRS 3 and IAS 36 will probably lead to changes in the budgeting process, and this will especially be the case in acquisition-intensive companies. It is not self-evident whether these changes will make management control less (or perhaps even better) aligned with the strategies being pursued. What we can say is that the budgeting process will in many cases be more important as a tool for making plans and prognoses for the development of the acquired company as well as controlling it. In that respect there could be a tendency for the planning system to be both more forward-looking but also more focused on short-term performance.

4.3.4 Financial Instruments and Effects on Budgeting

IAS 39 *Financial instruments: Recognition and measurement* is well known for being an accounting standard that is complicated to interpret. The complexities and the increased volatility, as discussed in the section on strategic planning, could have

effects on the strategies being pursued but also on activities related to the implementation of the strategies. Focusing on the latter type of effects and, as mentioned, the budget is important since it is a short-term planning tool that is instrumental in connecting the long-term strategic planning and the short-term follow-up processes. Here it can be concluded that budgeting may be either more or less tightly coupled with the external reporting. Budgeting may include fair values, but may also comprise values based on historical cost, depending on the business model. However, there could also be a decoupling of the information used in the financial reports, on the one hand, and the information used in budgeting, on the other. As we have already discussed in the section on strategic planning, the increased volatility in budget processes comprising more fair values could possibly be managed, at least partly, through hedging activities and a tighter integration between planning and risk management routines (cf. Wahlström 2009; Mikes 2011). These activities have the aim to ensure that the use of financial instruments is in line with the "risk appetite" of the company and does not violate the long-term strategic orientation (cf. Arwinge 2014).

Looking more closely at the budgeting process itself, we could probably also expect to find changes that relate to how both income and costs related to the instruments should be estimated. In line with the reasoning of the annual impairment test and the use of fair values (cf. Taipaleenmäki and Ikäheimo 2013), we believe that more forward-looking information must be used—such as market data (e.g. macro economic factors, prognoses for short-term market development). To interpret this type of data and truly make use of it in the budgeting process would be a challenge and also make the process more complicated, as well as more expensive. As mentioned above, making prognoses is a very difficult undertaking, and this is also the main reason why budgeting has a bad reputation among some practitioners and scholars (see for example Wallander 1999). The introduction of fair value accounting put these difficulties in the spotlight, which could lead to a situation in which the inherent weaknesses of budgeting would be obvious. As discussed by contingency theorists, a turbulent environment can make the budget less relevant (see for example Govindarajan 1988). Some companies could respond to this by not really trying to capture the effects of financial instruments in the budget—or at least not putting a great deal of effort into trying to estimate these effects.

To sum up and conclude, the main challenge for budgeting is how to make use of more forward-looking information and integrate it into the planning process. The increased importance of fair value accounting puts focus on both the possibilities and difficulties of all planning systems: how to plan for future events. As pointed out, we have identified two main scenarios. One scenario is that more resources are devoted to budgeting in an effort to make it even more focused on forward-looking information. The other scenario is to leave budgeting as it is and instead try to use other control mechanisms such as rolling forecasts. These scenarios could also be combined. In either case it would be a challenge to make these changes, and since they are closely linked to the business model, the alignment with the strategies being pursued could be affected.

4.4 Reporting and Analysis

In Chap. 1, we discussed the contradictory results of previous studies with regard to the influence of external reporting on management control. In this discussion the actual use of accounting for reporting internally is a central issue. The use of internal reporting, sometimes called performance measurement, points right to the heart of strategy implementation, as it implies in theory that a reporting framework with the relevant accounting data included can ensure that intended strategies are implemented (Anthony et al. 2014). Even though this may appear to be a straightforward internal issue for the company, it is not evident what should constitute the basis for such internal reporting, since strategy formulation and implementation are not done in isolation from external stakeholders. For example, Schaltegger and Wagner (2006)—who study sustainability management and the integration of environmental and economic information—have identified two different approaches to how performance is reported, where one is an outside-inward approach taking external debates and demands into account, and the other one is an inside-outward approach where the analysis of the key issues for effective implementation of business strategy is in focus. Within the company, it may not even be clear to managers what management control and especially the reporting of performance is actually based on. This was also discussed in Chap. 2, where we mentioned how management information needs in terms of reporting could have been influenced by the financial accounting view of the company. In such a situation, the external requirements are so well established that they have influenced the thinking about what constitutes useful reporting information internally (Joseph et al. 1996).

In addition, researchers have also found evidence that external and internal reporting practices do indeed seem to converge (Drury and Tayles 1997; Dugdale and Jones 2003). As mentioned earlier the reasons for this may be manifold. One example of a reason identified by several researchers is the cost-effectiveness of using only one reporting system and not two different ones. This aspect is something that has also been recognized by financial accounting standard setters when they argue for new accounting standards that are more explicitly based on internal reporting data. Another example from our literature review is connected to the above-mentioned one, namely the difficulty of separating external demands from internal demands, and that internal reporting based on external reporting data makes more sense for senior executives. However, to recognize that it may be both more efficient and logical to use one integrated reporting system does not tell us much about which reporting framework is actually dominating the other. It should also be noted that before the introduction of IFRS there is some evidence showing that companies did not submit goal parameters and outcome values for their segments in the annual reports to a large extent (Törnqvist 1999). Based on the four financial accounting examples described in Chap. 3, we will now go on to discuss the possible effects and relations between financial accounting and reporting and analysis.

4.4.1 Segment Reporting and Effects on Reporting and Analysis

As we described in Chap. 3, as well as in earlier sections in this chapter, the area of segment reporting is especially interesting, since accounting standard setters have explicitly called for an integration of financial accounting and management control. IFRS 8 *Operating segments* requires the company to use the so-called "management approach" when reporting performance of different operating segments, meaning that the reporting used internally by senior executives in their decision-making should also be used in the financial reports. Hence the data used for the external reporting would have a close connection to, or even be the same as, the information used in the reporting within the company. However, it is difficult to say, based on this point of departure, which information system would dominate the other. It is far from evident that financial accounting would dominate internal reporting; it is more likely that internal reporting would dominate external reporting. The reason is that external reporting, according to the new rules, would use the information from internal information systems to collect financial reporting data, thereby aligning the external reporting with the internal management structures of the company (Taipaleenmäki and Ikäheimo 2013).

IFRS 8 states explicitly that reporting used internally by management to report performance for each operating segment would be used, that is, that the segment should be identified according to how results are reviewed regularly internally by the so-called "Chief Operating Decision Maker" (CODM). This means adopting the view of "through the eyes of management" when designing and using financial reports. As Taipaleenmäki and Ikäheimo (2013), among others, have already concluded, this will require an integration of management control and financial accounting. However, and as mentioned above, even though the standard itself points to a situation where internal information would dominate over external reporting, the direction of the dominance must still be considered to be somewhat unclear. Taipaleenmäki and Ikäheimo (ibid.) also note that the segment reporting requirement could prompt changes in management control reporting as a result of the increased degree of transparency. For example, Roberts (1991), explains how accountability and visibility can cause the one being subjected to that visibility to take over the attitudes of the other, and that the one subjected to visibility risks losing him/herself and instead becomes captured and absorbed by the image that others offer. Transferring these ideas to the world of large corporations, with powerful external stakeholder groups, it is not unlikely that the company would start to think a great deal about the expectations of these stakeholders rather than the internal values and structures of the organization. In the long run, this may also change the way organizational members view the organization (Stockenstrand 2014a).

In sum, the influences between the external financial reports and the internal management reports should probably be seen as a two-way process, where internal reporting data is used, but where internal reporting practices could also be changed

as a result of external exposure. Another consequence that can be expected is that to the extent that internal reporting data is actually used, this is likely to be information that, on the one hand, will give external stakeholders a very direct and transparent view of how decisions are made within the company but, on the other hand, may be difficult to understand, since they will largely be company specific. The company's financial accounting will likely change and become more extensive with a larger amount of qualitative data that explains the company-specific measures used in the reporting and analysis and how they are connected to the traditional income statement and balance sheet. Another consequence connected to the possible challenge of relating internal reporting data to the income statement and balance sheet is the fact that IFRS, has a less conservative view regarding income recognition and measurement issues (Ewert and Wagenhofer 2007). Especially a company that goes through a transition to IFRS accounting may find that there will be differences in the basis for segment reporting compared to that in other areas of income recognition and measurement.

In regard to the connection between internal reporting and financial accounting, it is also likely that auditors will play some role. Here, the insights of Dugdale and Jones (2003) regarding why external and internal reporting practices may converge are probably relevant, suggesting that it may be easier to convince auditors of the validity of accounting information if the two systems are integrated. Another possible effect connected to the reasoning of Dugdale and Jones (ibid.) is that external authorities such as auditors may suggest solutions that could be seen as a form of "best practice". In this sense, exposing reporting and measurement structures externally may create a situation where the segment reporting of different kinds of companies starts to converge, since both the companies themselves and external authorities may strive to use a way of reporting that is understandable and that creates trust. On the other hand, the area of segment reporting could also create tensions and conflicts with auditors, since the principles-based foundation of IFRS is known to create new challenges for auditors (Beattie et al. 2008). For example, it is likely that there will be a need for more extensive discussions with auditors about strategically sensitive information that is required to disclose in the financial accounting. As a final remark, we also believe that the changes to segment reporting could result in a situation where companies take the opportunity to think through their internal reporting structure with regard to operating segments, something that in a best-case scenario could result in improved reporting (i.e. reporting better aligned to both internal and external demands).

4.4.2 Goodwill Accounting and Effects on Reporting and Analysis

The changes in 2004 to the standards IAS 36 *Impairment of assets* and IAS 38 *Intangible assets*, as we discussed in Chap. 3, had effects on how goodwill

was treated in the financial accounts. From being systematically depreciated, after 2004 goodwill was to be tested annually for impairment, and goodwill should be written down only in cases where the test showed that the market value of goodwill was lower than the book value. The new way of accounting for goodwill meant new procedures for impairment testing, something that could also affect internal reporting in various ways. New information would be needed in order to fulfil new requirements for mandatory disclosures in the financial reporting. This is likely to entail changes in reporting systems to handle new information needs for disclosures, such as key assumptions about discount rates, growth rates and so on. Since actual practices of impairment testing must also be disclosed, it is also likely that companies must find ways of documenting and reporting actual procedures.

However, as described in Chap. 3, these procedures have been criticized for not being sufficient or not standardized in nature. There is also reason to believe that reporting systems designed to document actual practices are not very well developed. It is likely that disclosures are not derived from internal reporting systems, but rather constructed in hindsight according to a standardized format. For example, the disclosure requirements for the impaired amount as well as the reasons for impairment seem to change from one time to another, meaning that it is probably not part of a regular reporting procedure. However, there may also be other types of information that need to be dealt with using reporting systems. The reason is that the new standard means that goodwill is one of the assets that have the highest demands for disclosures, which means a greater need for supporting internal reporting systems. For example, information about the amounts of goodwill per identified cash-generating unit must be reported and evaluated internally. Also, the valuation model used in testing the need for impairment probably needs some kind of reporting system, as do the procedures for sensitivity analysis, which is also needed as a consequence of the 2004 standard.

Finally, some previous research has pointed to the possibility that the financial accounting standard on goodwill enable managerial discretion when calculating fair values (see for example Detzen and Zülch 2012). However, other researchers have not found that this possibility for managerial discretion leads to lower value relevance of goodwill accounting information (cf. Olante 2013; Baboukardos and Rimmel 2014). This would mean that even though there are problems with lower degrees of disclosures that are less informative, this does not mean that the value of goodwill as reported in the annual report is wrong. These observations, which may in part be seen as somewhat of a paradox, could mean that the company does in fact have quite good control over its internal information. Since the level of disclosures has been found to be low, even though the value in the end is relevant, this implies that the information systems with regard to internal reporting, on the one hand, and financial accounting, on the other, have been separated. Hence, this would mean that companies are likely to have good control over information internally so that they can make correct choices with regard to goodwill, but that they do not disclose

this information externally on the same detailed level. The separation of systems could have the advantage of the company being able to have some leeway in case it is needed. Laskaridou and Athanasios (2013) have found how impairment testing may sometimes be used for "big bath" accounting, meaning taking several costs at once. Separating information systems would enable such actions.

In sum and to conclude, it is not possible to say whether the new IFRS accounting model for goodwill has meant that management control and financial accounting have become more or less integrated. However, since companies have been subjected to extensive criticism directed against their low degree of disclosures, it is likely that the two information systems, if anything, have been separated to a greater extent than before as a result of the introduction of IFRS.

4.4.3 Business Combinations and Effects on Reporting and Analysis

According to IAS 36 *Impairment of assets* and IAS 38 *Intangible assets*, and as discussed above, all assets and liabilities, and in particular intangible assets, are to be accounted for using fair value. The question in this section is in what ways, if any, this could affect the design and use of internal systems of reporting and analysis. Not only is it likely that it would lead to a change in reporting, but generally that it would lead to a greater overall need to keep track of a number of things. Especially, we believe that it will be more important for management to be able to use internal reporting information to make decisions about an acquisition, when the acquisition process becomes more complex and also involves several different parties, as we described in Chap. 3.

In this case, analysing the effects of these accounting standards in terms of a possible domination of one information system over the other is not fully obvious. On the one hand, it is likely that the internal reporting and analysis will use a great deal of external data, relating to fair values. On the other hand, acquisitions in large companies are strategically important. Previous research has suggested that in various industries, goodwill is a large component of the company's balance sheet (Baboukardos and Rimmel 2014). Acquisitions may also be an important part of how the corporate strategy of a company is changed and managed, and thus the strategy needs the support of the internal reporting and analysis processes. However, if the internal information is composed of external information, perhaps even partly defined and negotiated by external parties, it is likely that the approach discussed by Schaltegger and Wagner (2006), that is, an outside-in approach to strategy implementation, will be prevalent. This was also discussed in Chap. 2 when we acknowledged that it might be difficult even for senior executives to know

from which perspective the organization is, and should be, viewed in a situation where external pressures are strong. Given that the new standards will probably require a formalization of the process, such as using external objective parties to negotiate values, it is likely that external views will become more important. Still, it is interesting to ponder whether the situation of a possible conflict between parties over accounting values may also lead to a lower degree of transparency. A counterpart in a situation of negotiation could be forced to open its internal reporting as a measure to decrease insecurity and to be able to go ahead with the deal. On the other hand, with strong pressure from the other party, a company could also be inclined to become even less transparent.

A final aspect is the one brought up by, among others, Joseph et al. (1996), who claim that external requirements may eventually become so established that they influence the thinking about what constitutes useful reporting internally. One consequence of the changes to the business combination standard may be that managers become more inclined to feel that, for example, fair values of intangible assets is the most relevant way of accounting even for the internal reporting system. Even though it is difficult to know whether it will lead to an integration of information systems or not, it appears likely that a company would have an increased need to keep track of fair values and their calculations in the process of an acquisition. Implementing such information systems could possibly have an effect on how information is gathered and used also after the acquisition in the sense that for example intangible assets and their fair values will be more in focus internally. In such a situation, cost reasons may be a factor in eventually abandoning internal systems that are not that important in order to meet external demands.

4.4.4 Financial Instruments and Effects on Reporting and Analysis

The area of accounting for financial instrument is one with many different issues that could be discussed in relation to reporting performance internally. To begin with, we have concluded that the introduction of IFRS in countries such as Sweden meant that fair values were to be used in accounting for a broader range of financial instruments. Also, even though market prices could not be found for a particular asset or liability, fair values were to be calculated using quantitative models. Other changes related to financial instruments were, for example, changes to hedge accounting, especially with regard to formal requirements, processes and systems. In this section we will discuss several issues that are all related to financial instruments and their possible effects on internal reporting and analysis.

One first issue that could be brought up as a consequence of the generally more extensive use of fair values when accounting for financial instruments is that there could be a mismatch between how the company perceives itself to be managing the

instruments and the way they are accounted for. For example, Stockenstrand (2014b), discusses how fair values could be seen as a problem in a company that does not intend to sell the asset before maturity, and where short-term changes in the value of the asset are not interesting to the company. In such a case, it is likely that companies would wish to separate the underlying value of the financial asset from its fair value, and use the underlying value in the internal reporting for the purpose of management control. Such a situation would actually create a need for a separation between financial accounting and internal reporting. However, we should bear in mind the possible difficulties stemming from the need for separation of reporting systems in a more traditional and low-risk banking business.

The use of internal information in financial reporting could also be discussed looking at fair values where there is no active market leading to a situation in which fair values are to be calculated using managerial assumptions. Alexander et al. (2012) discuss how respondents from companies answered in the open due process of accounting standard setting with regard to financial instruments and fair value accounting. One point appeared to be a concern about managers not using internal reporting objectively when information for fair value calculations is to be given. The manager has more information than the external stakeholders, meaning that all market values that are not quoted prices will have some degree of subjectivity inherent in them. Here there may be a link to the internal reporting system. It may be a question of discretion in that management may use the information subjectively or selectively. However, what is perhaps even more likely is that internal reporting systems may set limits for what is achievable in terms of financial reporting.

The discussions above relate to the ways in which the internal reporting and the strategies of the company may set limits or create particular internal needs in relation to the more extensive use of fair value accounting with regard to financial instruments. However, there are also effects in the other direction, in that standards relating to financial instrument accounting will affect internal reporting practices. One such example is the effects of hedge accounting.

The new rules for hedge accounting have entailed an increase in the amount of administrative work because of increased needs for documentation, for example, with regard to the effectiveness of the hedge. This might have meant that not only have new systems had to be implemented, but also changes in the ways that the bank works—new processes and routines. This raises the question of the flexibility of reporting systems and how easily these can change. In a situation where there are new needs for information that has not been demanded earlier, it is not always certain that current systems can be adapted in order to meet new demands. Furthermore, different banks may have different needs, which makes it likely that in such a situation they will develop their own reporting systems that suit the way the organization works and will be compatible with systems that are already in place. Developing new internal reporting systems will then most likely be a question of collaborating with external system vendors, in combination with in-house development of the system in order to make it unique. With regard to hedge accounting there are also different models for assessing effectiveness, and banks may have

chosen somewhat differently, thus making the system needs different. However, the external vendors may provide some increased degree of uniformity between banks in that their systems is a result of the vendors providing similar solutions to new demands. But it can also be the case that entirely new reporting systems will need to be implemented. This leads to the issue of whether the administrative processes change the view of the financial instrument and the choices made in relation to that instrument, or whether the administrative processes become "decoupled" from the way the financial instruments are looked upon strategically.

4.5 Rewards and Compensation

According to the principal-agent theory (see for example Jensen and Meckling 1976) the separation of ownership and control gives rise to the need to align managerial compensation with the interests of owners in order to maximize the value of equity. This is something that may in turn affect how senior executives behave in different situations, especially in relation to accounting choices. The basic idea according to principal-agent theory is that senior executives are likely to make accounting choices that lead to better results in a situation where their compensation is linked to performance (e.g. profit). This poses many interesting questions with regard to changes in accounting standards.

In this chapter, we do not go into detail with regard to different kinds of reward and compensation models. Rather we discuss the issue of reward and compensation from a general perspective, where performance is evaluated and rewarded based on the level of profits. Most often, executive compensation consists of different parts, with some long-term components and some short-term components. Since there is often a component in the compensation plan that is linked to cash-based compensation, the short-term perspective of reported profits and accounting choice becomes important.

According to Detzen and Zülch (2012), performance as disclosed in the financial reports plays an important role in determining the level of compensation. However, the profits in financial reports are not "given by nature", but are rather the result of the interpretation and implementation of accounting standards. Flexibility in this sense creates an opportunity for earnings management. As was discussed in Chap. 3, several of the examples chosen gave rise to the question of a possible increase in managerial flexibility. Principles-based accounting standards, as well as a general move away from a more conservative accounting regime, may lead to a situation in which executive compensation becomes an important issue in understanding accounting practices. Below we discuss possible effects with regard to each of the four accounting areas identified in Chap. 3.

4.5.1 Segment Reporting and Effects on Rewards and Compensation

The area of segment reporting is interesting since it may create a tension between internal reporting and evaluation of individual executives, on the one hand, and external reporting, on the other. To discuss this tension we need to acknowledge that there are different kinds of rewards. One reward model is a fixed one over which the executive does not have very much influence. Rewards can also be variable and are often connected to a result that the executive has the ability to influence and where the reward is a way of creating incentives for better performance. One way to describe it is to say that the new standard (IFRS 8 *Operating segments*), with the approach of seeing segments "through the eyes of management", makes the performance of individual executives more transparent. However, the aggregated results of a segment are most often the result of a group effort, of many different tasks that are not easily identified. This could mean that there will not be any significant effects relating to rewards and compensations in the organization as a result of the new standard.

On the other hand, we concluded in Chap. 3 that executives were given more control over reported information with the new standard, something that also was brought up as a criticism when it was introduced (Nichols et al. 2013). This implies that executives do have the possibility of managing reported results with regard to segments, which may be used in their favour. There may be many different reasons to do that, for example that executives wish to portray the company in a positive way for legitimacy. Another possible reason is that there may be financial rewards for them to gain in doing so. In such a case, executives would also be more in control of their rewards, given that these rewards are connected to reported income. This in turn would mean that the new accounting standard could exacerbate problems of earnings management (Okamoto 2011) in cases where the reward model entails a strong connection between an executive's compensation and the reported segments. Also, Hodder and Hopkins (2014) suggest that executives that were given higher private benefits as compensation for performance had higher incentives to resist reporting transparency. There are many possible reasons for this.

The first one is linked to the conclusion by Jensen and Meckling (1976) that there is a higher possibility that executives will receive private benefits when agency problems are significant. A higher degree of transparency would then decrease agency problems by increasing the amount of information (i.e. decreasing information asymmetries between owners and senior executives). It is likely, however, that individual executives may be reluctant to expose their individual performance externally. Roberts (1991) discusses the individualizing effects of hierarchical accountability, which a reward system connected to financial results is a typical example of. He argues that accounting information plays the role of a mirror in making individual activity visible and getting individuals "nervously preoccupied with how one is seen" (ibid., p. 355). Such a hierarchical form of accountability and its effects as well, is likely to become even stronger when

officially exposed. From the individual executive's perspective, it thus appears unlikely that they would be in favour of having individual rewards connected directly to segments when reported according to IFRS 8. This may lead to a situation where an organization's reward models could be altered as a result of the new standard. The reason would be to protect individual executives from external visibility and exposure with regard to how they actually succeed in managing each segment—exactly the type of information that IFRS 8 wants to make visible in the financial accounting.

Another interesting line of research is focused on the number of segments being reported. In Chap. 3 it was concluded that the new standard had indeed resulted in a situation in which a larger number of segments are reported. Carnes and Guffey (2000) do not discuss the choice of bonus plan from the individual executive's perspective, but rather found a connection between the bonus plan chosen in multinational companies and the number of segments that the company was operating in. The existence of more segments provided an incentive for the company to use specific reward models that could enhance executives' strategic thinking with regard to taxes. It may also point to the fact that even though it is not optimal from the point of view of individual operating decision makers to have their reward plans connected to externally disclosed segments, it may actually be of interest to the company as a whole to connect rewards and compensations to operating segment profits if the company would like to maximize the way in which segments are reported to the outside world. This would especially hold true in a multinational corporation operating in many different segments. In such a company, the new financial reporting standard could then be used by owners and the board of directors to create the right mind-set among senior executives.

4.5.2 Goodwill and Effects on Rewards and Compensation

Research has shown that the goodwill accounting may be linked to managerial compensation (Detzen and Zülch 2012). As we described in Chap. 3, many large companies did not like the prohibition of the pooling method that allowed two companies to merge without giving rise to any goodwill and hence with no amortization costs. However, it seems that this disadvantage was considered to be "compensated for", at least to some extent, by the introduction of impairment testing.

Detzen and Zülch (ibid.) find that there is indeed a relationship between the amount of goodwill recognized in an acquisition and the use of cash bonuses in executive compensation. In particular, the new way of accounting for goodwill in terms of it being subject to annual impairment tests has meant a larger degree of discretion (ibid.). Not only does it apply to the recognition of goodwill, something that will also be discussed below in relation to business combinations, but also to the consequent valuation of the goodwill, in which executives use what are often called level-3 inputs for intangible assets. These inputs for fair value measurement are unobservable and are typically a reflection of management's estimates about the

assumptions that hypothetical market participants would make. In most cases the fair value is then calculated using some model-based technique. Even though the models used by companies are often similar, the inputs give rise to managerial discretion. Such discretion comes from what could be described as an information asymmetry in relation to owners and funders, since these stakeholders do not know the exact input used in the valuation. By making use of this discretion, senior executives could recognize more goodwill (as a consequence of managerial hubris) and not recognize write-offs in the impairment tests. This could possibly create a higher net income in the financial reports, something that could be of interest to an executive with a compensation model based on reported profits—at least in the short term. As Detzen and Zülch (ibid.) have also shown, such behaviour could lead to lower bonuses being paid in the long term.

To gain deeper insight into what the connection between goodwill accounting and rewards and compensation is in practice, we must also look into research conducted on actual goodwill accounting practices. In doing so, we can conclude that there are mixed results in terms of how goodwill is treated. Even though an increased possibility of discretion has been created by the introduction of goodwill impairment, there is research pointing to the fact that goodwill recognition has actually become timelier than was previously the case, since it better mirrors the actual development of markets and prices (Olante 2013). If goodwill is indeed impaired when it should be, then the hypothesis that executives use goodwill accounting discretion to increase their individual compensation can be called into question. However, other studies, such as the study of 235 issuers with large goodwill amounts in their financial reports conducted by the European Securities and Markets Authority (ESMA 2013), concluded that in times of poorer economic growth, many companies that would have been expected to write down goodwill did not do so. This led ESMA to question whether levels of impairments did in fact mirror economic reality correctly or not. Even though this conclusion is interesting, it is difficult to say whether and in what way it can be linked to rewards and compensation.

ESMA (ibid.) also points out the lack of disclosures with regard to impairment assumptions, which makes it more difficult to know in what ways inputs are used. Also, a lack of explanations for accounting choices also makes it difficult to understand the reasons for different courses of action. The company as a whole may have various motives in their reporting. Also, it may not be the case that companies or individual executives are always striving to increase current profits. Laskaridou and Athanasios (2013), for example, discuss how impairment testing can also be used for “big bath” accounting, where costs are taken at one single time in order to increase future profits instead. This may be linked to the interest of individual executives but also to other things. The authors find that goodwill impairments are indeed more common in years of lower profits, but they do not find evidence that this is linked to managerial discretion. As a final point, it can be discussed how rewards and compensations work in an accounting environment that

may entail a larger degree of volatility in profits caused by for example more unpredictable developments in impairments than was previously the case. With more volatile earnings, models for rewards and compensation may be changed over time, in order to create a more predictable model for performance compensation.

4.5.3 Business Combinations and Effects on Rewards and Compensation

The changes in accounting for business combinations share similarities with other areas discussed, since they point to the expansion of fair values in accounting. The changes to IFRS 3 *Business combinations* in 2008 were in this case closely linked to the collaborations with the FASB and the resulting changes in SFAS 141 *Business combinations*, a standard that entailed recognizing both acquired assets and liabilities at fair value.

The area of mergers and acquisitions has long been of interest to researchers, not least against the background of various managerial motives. That the standard guiding the accounting for business combinations has been changed so that managerial discretion is affected makes it even more interesting. For example, Brown and Sarma (2007) depart from the idea that there can be many different motives for undertaking an acquisition from a managerial perspective. These motives could be connected to the objective of creating synergies for the company as a whole and as a part of what the executive wants to achieve in doing a good job. But it could also be something that could be motivated by an executive's own objectives and even hubris (cf. Detzen and Zülch 2012). Both these motives could be discussed in the light of the way an acquisition is accounted for. On the one hand, if the motives for undertaking acquisitions are based mainly on opportunities for value creation, then fair values must be seen as a rational choice, since they are supposed to better reflect future cash flows. However, if the motives for undertaking an acquisition are mainly based on the executive's personal objectives, and even their hubris, then fair values and the discretion that comes with them could also be seen as a problem. This is especially problematic against the background of the discussion in Chap. 3 about concerns being raised with regard to the lack of detailed guidance relating to how fair values should be determined. Given that the hubris on behalf of the CEO can take the form of the overestimation of potential synergies, fair values could play a role in creating overly optimistic calculations.

One important aspect, also discussed by Brown and Sarma (2007), citing Hayward and Hambrick (1997), is the perspective that departs from research indicating that the level of CEO hubris increases with the level of CEO compensation. This would mean that the higher the financial rewards and compensations are, the more likely it is that fair value accounting in acquisitions could result in overly optimistic valuations. Brown and Sarma (2007) distinguish between overconfidence, something that refers to the general over-optimism from the

managerial perspective, and dominance, which is the direct attempt to affect personal gains. In this context they argue that “Dominance may follow from overconfidence, but not all overconfident CEOs will be dominant. In a corporate context, a decision in which an individual is very likely to wish to exert dominance is in the determination of their personal compensation” (ibid., p. 364). A possible result with regard to fair value of assets and liabilities in acquisitions may be that companies will be forced to change their compensation plans in order to avoid problems of agency conflicts. Another question is whether certain kinds of compensations may further enhance problems in fair value accounting in acquisitions. Chen et al. (2006) found that in banks with option-based executive compensation, the risk-taking of executives increased. This may also be a factor in acquisitions, where risk may be an important variable, especially if the executive perceives that an increased level of risk-taking will be connected to higher future economic benefits. The authors conclude that this may highlight the importance of external regulation with regard to risk-taking, especially in the banking sector where it can have widespread socio-economic effects.

4.5.4 Financial Instruments and Effects on Rewards and Compensation

As was described above in relation to reporting and analysis, the introduction of new accounting treatments for financial instruments has entailed several changes, not least in administrating and dealing with formal demands surrounding hedging, for example. Fair value accounting has been introduced as part of IFRS to a larger extent than was previously the case. However, some financial assets and liabilities are still not accounted for using fair values.

There are several choices regarding how to use fair values, for example via the fair value option. It was concluded in the section on internal reporting and analysis that it is not unlikely that new reporting systems need to be implemented, or at least be modified, in order to deal with new information demands externally when fair values are used. In order to manage the extensive demand for disclosures relating to fair values, new systems and routines are probably needed. However, it is difficult to know to what extent managerial discretion has in fact increased as a result of new routines and demands, or whether there may be other more important considerations on behalf of the executive. For example, fair values of financial assets and liabilities are connected to many other considerations such as risk management, capital management and earnings management. This does not have to be connected to executives receiving private benefits, but also to capital requirements or other aspects that the organization has to take into account. It has been discussed how the introduction of fair values, just as in the case of goodwill, is likely to introduce the possibility of a higher degree of managerial discretion. This could for example be the case in the units of a bank that manages financial assets held for trading, units that are likely to use fair values in their management control systems. Other aspects

are that valuation models that are predefined and used by many other actors, as well as a reliance on external expertise, may bring a certain degree of uniformity to the process.

The connection between fair values and executive compensation has been studied in previous research, for example looking at the motives of bank CEOs (Livne et al. 2011). The issue of fair value as a basis for executive compensation is highly interesting, since it sheds light on the question of the relevance of fair value as an internal measure of performance within an organization. This is connected to the question of whether fair values in banks for example, are a good measure for both economic planning and follow-up within the management control system. Livne et al. (2011) depart from the problem of using fair values as a basis for executive compensation in that the fair value measure contains unrealised profits that may change or even turn into a loss in the future. However, when fair value measures are increasingly part of the final profit and loss account according to IFRS, it is also logical that executive compensation could be based on that measure, especially in relation to assets that are managed with the intention of short-term profit, such as assets held for trading and assets available for sale. Livne et al. (2011) discuss the pros and cons of using fair values as a basis for executive compensation. One advantage, they say, is that it is harder to manipulate fair values. On the other hand, there is vast criticism of fair value measurement as being subjective and unreliable. The authors conclude that the relevance of fair value as a compensation basis is dependent on the bank's business model. We agree, since from a contingency perspective, strategy and management control systems should be aligned. It is likely that fair value as basis for executive compensation will be more relevant in a bank with a business strategy focused on short-term trading than in a bank with a focus on a traditional lending and deposit business strategy.

Hodder and Hopkins (2014) have investigated executives' motives against the background of introducing fair value accounting in certain financial assets in banks where fair value could be seen as less relevant (e.g. fair value measurement of loans). The authors refer to an exposure draft by FASB from 2010 suggesting that both fair values and amortized cost for loans should be reported, which theoretically would not mean a loss of information, but only an addition of information and thus an increase in the level of transparency. However, this suggestion was heavily criticized. One of the reasons, the authors found, was that the new proposal would result in a standard that would remove "accounting slack" that could be used to smooth income by creating reserves in good times and realizing them in times of crises. However, the authors also propose that executives may have more personal reasons to resist the standard. Such private motives could be connected to different kinds of incentives tied to the development of the value of the financial asset, and private benefits may in general be a reason to resist an increased degree of transparency. Interestingly, however, the authors (ibid.) suggest that the private reasons cannot be found to edge out the reason connected to accounting slack. This would support the idea that social norms and values can be very strong in a company, and that being able to support these norms and social traditions (for example in relation to income-smoothing behaviours) could be more important to

individual executives than reaping private benefits. This leads us to acknowledge that rewards and compensations are not only financial in nature, but could also be a part of the organizational culture. Roberts (1991), as mentioned, points to the strong forces of social forms of accountability and how accountability also gives an individual an identity. New accounting standards—creating increased transparency into operations or imposing new ways of working—may put executives in a delicate situation where they have to deal with needs to change parts of the organizational culture, and in that sense perhaps run the risk of not perceiving the more socially determined rewards within the organization.

4.6 Conclusions and Implications

In this chapter we have analysed four areas within accounting standard setting that have entailed changes as a result of implementing IFRS. The four areas have been segment reporting, goodwill accounting, business combinations and financial instruments. As was discussed in the introductory chapter, we depart from the idea that financial accounting and management control are the most important information systems in a company, making it relevant—in times where one or both of these systems have undergone large changes—to analyse how these information systems can be expected to affect each other. Another point of departure is that the two information systems have partly different information purposes, and are designed for different kinds of decisions for different stakeholders. With an increased focus on decision-usefulness in financial accounting, it becomes important to conceptually and analytically discuss in what ways this may also alter the ways in which management control systems can still serve the purpose of internal decision-making. In order to find out to what extent the information that is produced within the financial accounting information system also becomes relevant for internal decision-making in strategic, tactical and operational decisions, we have analysed the four financial accounting areas that can be expected to affect the management control system.

We have discussed possible effects of financial accounting on management control design and use in the dimensions of strategic planning, budgeting, reporting and analysis, and finally rewards and compensation. Ultimately we want to analyse whether we have reason to suspect a new "relevance lost" development, where a stronger emphasis on the demands from the outside in the design and use of the financial accounting information system could possibly lead to management control systems losing their relevance for internal decision-making. By reasoning based on our knowledge and experience in the area, as well as results from our literature review, we have sought to raise questions about possible effects, rather than to empirically find evidence of those effects—something that previous research has

found to be very difficult. However, we have used four empirical examples of financial accounting standards that appeared interesting, since they have attracted a great deal of attention among constituents.

In Chap. 3 we discussed how examples from recent changes in financial accounting standards indicate that there might be stronger forces coming from both information systems than had previously been described in the literature. Also, standard setters may even more explicitly encourage the integration of financial accounting and management control systems. The strong interests of owners and funders do not appear to result in a very clear opinion regarding how certain values should be calculated (even though there has been a strong tendency towards a larger proportion of fair values in the last few decades). Rather, there is increased interest in obtaining insight into the structures and processes that are used within the management control system. This could mean that the management control system will become more exposed and thus more affected by external interests. But it could also mean the opposite: that the external reporting is slowly losing its relevance, in that it is becoming too much a result of internal (and perhaps subjectively collected and summarized) information. This was partly discussed as a result of financial accounting standards being more principles-based, leaving room for interpretation and judgment by the company.

We began by looking at possible effects on strategic planning in the four financial accounting areas. In the area of segment reporting we have seen an ambition on the part of financial accounting standard setters to create integration between external and internal decision-making by using internal information for external reporting purposes. In this chapter we discussed that this may lead to a better integration between how the strategies are described in the annual report versus in the internal reporting system, and that their implementation will become more focused owing to increased transparency. Following increased transparency and scrutiny, management may also put more efforts into fine-tuning strategic planning and making it even more integrated with other parts of the management control system. Perhaps one might even expect that strategies will become simpler in order for them to be more easily explained to the outside world. In the area of goodwill accounting and the area of business combinations as a whole, we identified possible changes to the planning process where acquisition strategies may change in how they are executed, that is, involving more external and independent expertise, being done in a more thorough way with sensitivity analysis etc., and also being more reliant on forward-looking information. Managers with a fair value regime will get faster feedback on bad decisions, something that could perhaps speed up certain decision-making processes. Lastly, we found that strategic planning, especially in financial companies, has undergone changes in several respects during the last decade. For one, disclosure requirements have become much more extensive, probably making disclosed information more important internally as well, for example with regard to risk management and capital planning. Fair value accounting in general places greater demands on strategic planning,

especially since it is likely to lead to a larger focus on short-term strategic planning, partly as a result of increased uncertainty.

Moving on to budgeting, we discussed, along the same lines as for strategic planning, that budgeting practices may become more aligned with strategies as a result of changes in financial accounting. This may enhance transparency in the budgeting process, but as a result may also make budgeting more prone to be affected by external needs. One example is that the budgeting process might become more focused on the short term. In the case of goodwill, the budgeting process is likely to change as a result of impairment testing, since it must incorporate the ability to use forward-looking information. Budgeting may also be enhanced by new IT systems. This is probably also the case in relation to business combinations, where information in the budgeting process may also change in character to become more oriented towards market data. A similar development is found in the area of financial instruments, where new systems of budgeting and reporting have been implemented in recent years to deal with market values and new information that is required (e.g. risks).

In the area of reporting and analysing performance, the question came up again whether the management control system may become more intruded upon by external demands as a result of the new segment-reporting standard. We analysed for example how internal reporting may become affected by external reporting, but concluded that it will probably be a two-way process where the two reporting systems will be affected by one another. In the case of goodwill, business combinations and financial instruments, it appears that external demands are more likely to affect reporting, both in form and in content. For example, hedge accounting has been known to introduce much more administrative work and new routines in reporting.

Finally, we have analysed rewards and compensation, where all four areas are expected to enhance the transparency of managerial work. It was concluded that the form of compensation might also be relevant in understanding the different effects. For example, in a situation where fair values are used, there might be differences in whether compensation is cash-based or equity-based. Executives may become more inclined to manipulate results, take on more risks etc., but on the other hand, results might also be more exposed, making executives more visible both in terms of successes and failures. However, against the more general implementation of principles-based standards, executives may generally have more leeway in making interpretations that are beneficial for the company. In that respect, management control systems could possibly be more decisive.

Chapter 5
Concluding Reflections

5.1 Introduction

This last chapter is a summary of the book and presents our concluding reflections regarding how financial accounting and management control are related as well as the tensions and conflicts between these two information systems. Our aim of the book is to understand how management control systems are affected by financial accounting, but also how management control systems can affect financial accounting. As discussed above, the main difference between management control and financial accounting is that the former is designed and used for strategic, tactical and operational decision-making in order to improve competitiveness and value-creation. The latter is used for evaluating the company's value creation and competitiveness. To be able to make such an evaluation, financial reports must be comparable, which creates a strong demand for uniform financial accounts. The management control systems, on the other hand, must be designed and used to fit the strategy of the company. This creates a demand for control systems that are unique.

To be able to tentatively analyse the possible tensions and conflicts between uniformity and uniqueness we need a framework or at least some theoretical starting points that could help us explain what affects the design and use of financial accounting and management control. In Chap. 2 we discussed a number of models and frameworks, some of which are well known among both practitioners and scholars. Unfortunately there are only a few models and frameworks, at least to our best knowledge, and only one of them provides a detailed analysis of the tensions and conflicts. The exception is the framework by Taipaleenmäki and Ikäheimo (2013), which has an interesting and rather detailed analysis of the convergence of financial accounting, management accounting and the role of IT in facilitating that process. Even though the framework by Taipaleenmäki and Ikäheimo is a welcome contribution to the literature, we can conclude that there is a need for continued conceptual work in this area. One aim of this book is to contribute to this stream of

© Springer International Publishing Switzerland 2015

F. Nilsson, A.-K. Stockenstrand, *Financial Accounting and Management Control*,
Contributions to Management Science, DOI 10.1007/978-3-319-13782-7_5

literature and by doing so provide an extended analysis—even though it is still tentative and explorative—of the complex relationships between financial accounting and management control.

We developed and presented our framework in Chap. 2 and used it to structure and guide our analysis in the following two chapters. In the next section we will revisit the framework and discuss it based on our analysis. As the reader will notice, one important finding is that the relationship between the two information systems is very complex and can be different in character depending on the specific accounting standard and the specific category of the management control process being analysed. We will then continue by discussing whether the relevance of financial accounting and management control has been lost or actually regained. Finally we will end the chapter by summarizing the book and providing the reader with some overall conclusions and implications.

5.2 The Framework Revisited

The "Relevance Lost" debate resulted in several studies investigating whether, and to what extent, financial accounting affects management control (Johnson and Kaplan 1987). In Chap. 2 we concluded that the results from these studies did not give a coherent answer. It seemed that the negative effects that Johnson and Kaplan (ibid.) observed in the US were not found in Europe—at least not to the same extent. One reason could of course be that relatively few studies were conducted. It should also be noted that some authors did identify a tendency towards a convergence between financial accounting and management control (Drury and Tayles 1997; Dugdale and Jones 2003). Examples of reasons put forward as an explanation, and already discussed, were (1) the high costs for maintaining two different information systems; (2) that a great deal could be gained by using the same information that external stakeholders are using; and (3) that financial accounting regulators present "best practice" solutions. These types of arguments are difficult to dismiss and are repeatedly presented by scholars and practitioners (see for example Hjelström and Schuster 2011).

The introduction of IFRS in 2005 for quoted companies in Europe resulted in the introduction of a new accounting regime. Financial accounts should no longer primarily serve a stewardship role but more an investor role instead (Taipaleenmäki and Ikäheimo 2013). As earlier mentioned in Chap. 2, some of the identified benefits of introducing IFRS were improved comparability between businesses, increased transparency—but perhaps most interesting—a possible harmonization of internal and external reporting (Jermakowicz and Gornik-Tomaszewski 2006). In countries like Germany, in which financial accounting and management control had been separated for a long time, the introduction of IFRS led researchers to discuss the advantages and disadvantages of a possible integration of the two information systems. One example is Ewert and Wagenhofer (2007), who argue that IFRS provides more future-oriented and more relevant information for external

and internal stakeholders than historical cost-accounting. They also believe that it is advantageous for both types of stakeholders if their decision-making is based on the same type of accounting information.

To conclude, IFRS seems, at least to some researchers and practitioners, to be an accounting regime that has the potential to bridge the gap between financial accounting and management control. One of the main reasons for this is the focus on forward-looking information, which is also valuable in the management control system process. There is also a strong tendency both among practitioners and researchers to discuss the advantages of integrated information and increased transparency (see for example the corporate responsibilities continuum or integrated reporting discussed in Chap. 2). At the same time there is also a tendency to try to make the differences between financial accounting and management control smaller than they are. For example, to claim that both systems are used to evaluate past performance for accountability purposes and make rational capital allocation decisions is of course correct (see for example, Lambert 2007). But this does not address the fundamental issue of the different logics that financial accounting and management control are based on, the former on a capital-market logic and the latter on a managerial logic (Miller and Power 2013). In the following subsections we will discuss these logics in more detail and also whether the differences between them are so great that they cannot be overcome or resolved. We start with the managerial logic and the demands for uniqueness followed by a discussion of the capital-market logic and how that creates a demand for uniformity.

5.2.1 Demands for Uniqueness

Managerial logic is based on the normative view that a company's control systems should be designed and used in accordance with the information needs of senior executives and employees (see for example Anthony et al. 2014). Since every company has a unique situation (in terms of e.g. environment, industry, size and technology) the strategic orientation will be different between companies, and consequently, the information needs of senior executives and employees will also be different (see for example Nilsson et al. 2011). This view, which has its roots in contingency theory, can be criticized for being overly simplistic. It has also been challenged by institutional theory (cf. Scapens 2006)—something that will also come back to in the concluding sections. Still, and as discussed at length in Chap. 2, considerable effort has been devoted to explaining how the environment affects strategies and control systems and how the strength of this alignment affects performance and competitive advantage (Langfield-Smith 2007; Miller and Power 2013). Lately the alignment of strategies and control systems between different organizational levels has attracted attention, showing that strategic congruence and integrated control have beneficial effects for competitiveness and value creation (Jannesson et al. 2014). The importance of integrated control systems has

also been highlighted in frameworks such as the management control package (Malmi and Brown 2008).

One of the questions that we are trying to answer in this book is to what extent it would be possible to also align these complex control systems to requirements coming from outside the company (e.g. owners and funders). The analysis in the two preceding chapters does not give a simple and conclusive answer to that question. What we have observed, and will show in more detail in the concluding sub-section, is that management control can be expected to be affected by financial accounting standards. The effects vary considerably depending on the type of accounting standard discussed, but also with the type of management control activity being analysed. In many of the cases there will be changes affecting the control process and the information used. One example is the strategic planning process being affected by the introduction of financial instruments, a change which requires more forward-looking information when making plans. With few exceptions these changes contribute to making the control processes even more important—and probably as a result of that—they are attracting more attention from the board and senior executives (cf. Ocasio 1997; Ocasio and Joseph 2008), the main reason being that many of the changes will increase transparency but also that external and internal stakeholders use the same information to a larger extent than before (e.g. Barlev and Haddad 2003; Ewert and Wagenhofer 2007). In sum this can be expected to lead to a situation in which the company must justify and explain both their strategies and the results of these plans in greater detail, resembling to some extent the interactive type of control discussed by Simons (1995).

The type of effects and changes discussed above is probably what some authors claim will enhance the possibilities of integrating financial accounting and management control (e.g. Haller and Eierle 2004; Jermakowicz and Gornik-Tomaszewski 2006). As our analysis shows these claims seem reasonable. But what about the effects on the alignment between strategy and management control? Do financial accounting standards (i.e. IFRS) affect this alignment and in what way, if any? To answer these questions we have to build on the findings in articles identified in our literature review as well as our own reasoning. Even though this analysis is explorative in character there are reasons to believe that changes in financial accounting can affect alignment. At an overall level we can expect that the introduction of IFRS will increase the importance of financial information. The use of fair values can also lead to a short-term orientation, since changes in the market value of assets and liabilities will affect the income statement and balance sheet. These two changes in combination can result in a tighter follow-up of the company. Based on these overall changes, it is likely that changes in financial accounting will lead to a situation in which management control will also use more financial information and apply a more short-term and tight follow-up. Studies with a contingency-theoretical perspective have shown that such a design and use of the control systems are suitable for companies following a portfolio management strategy and for business units pursuing a cost-leadership strategy. It is not equally

suitable for corporations following an activity-sharing strategy and business units pursuing a differentiation strategy (see for example Jannesson et al. 2014).

To conclude, there is no doubt that financial accounting affects management control. The extent and impact of the changes are more difficult to assess. Several of the changes are direct and affect the control process such as information gathering and distribution, the configuration of the IT systems etc. Other effects are subtler and are related to changes in the attention of the board and executive management. One such effect is increased transparency. Another effect is a possible and gradual weakening of the alignment of strategies and control systems. At the same time we should also take into consideration that, depending on the strategies pursued, some of the regulatory changes in financial accounting could actually strengthen the alignment. In addition, and adding to the complexity of the analysis, there is also a possibility that effects from one accounting standard on a specific management control activity could be counterbalanced by effects resulting from other standards. In sum, the combined effect of several standards on the management control process and its activities is difficult to foresee, and we will discuss them further in the section below on "Tensions and conflicts". We will now move on to discuss demands for uniformity in financial accounting and whether we can expect an increased level of comparability as a result.

5.2.2 Demands for Uniformity

Capital-market logic is based on financial accounting being primarily used by external stakeholders for evaluating value creation and making investment decisions. In accordance with this logic, financial accounting should provide owners and funders with information that can be used to hold the board and senior executives accountable (Lambert 2007). Principal–agent theory puts a lot of emphasis on decreasing information asymmetries between principals and agents (Jensen and Meckling 1976). To be able to achieve that, accounting information must be transparent, comparable and of high quality. As described above, IFRS was introduced for these reasons, with the overall objective to make capital markets more efficient (Jermakowicz and Gornik-Tomaszewski 2006; also referring to Choi and Meek 2005). Without doubt the efforts by IASB to harmonize financial accounting have not been in vain, as reported by Mustata and Matis (2010), for example. They showed that as a result of IFRS the level of material harmonization has increased. New financial accounting standards are thus an example of isomorphism, which is a construct used in institutional theory to explain uniformity in organizational processes and structures (cf. DiMaggio and Powell 1983; Scapens 2006). At a more detailed level of analysis, our discussion indicates, in line with Brandau et al. (2013), that all three types of isomorphism identified by DiMaggio and Powell (1983) are present.

In our theoretical framework we presented different forms of isomorphism according to the reasoning by DiMaggio and Powell (1983). Using that

terminology, our analysis in Chaps. 3 and 4 shows that so-called *Coercive isomorphism* (i.e. rooted in political influence) is evident in the strong influence that regulators, such as IASB and FASB, have on financial accounting harmonization and the implementation of standards. That type of formal isomorphism is made even stronger by informal isomorphism. An example is expectations from owners, funders and other stakeholders that companies implement new accounting standards and follow what could be considered to be "best practice". In other words there are reasons to believe that the board and senior executives think that their own, and the company's, reputation and legitimacy will be improved by implementing these new standards. There are also reasons to believe that companies copy how other companies report their financial performance—so called *mimetic isomorphism*. One example is that companies organize themselves in networks in order to account for financial instruments in the same way (Stockenstrand and Nilsson 2013). Finally there are *normative pressures* from auditors and accountants to adapt new accounting standards. As discussed by DiMaggio and Powell (1983) strong pressures for uniformity can be expected in fields that put a lot of emphasis on formal education and professionalism (e.g. auditors). Our analysis shows that companies are influenced by that type of pressure.

We can thus conclude that insights and analytical concepts from principal-agent theory and institutional theory can help us understand why financial accounting is primarily designed and used based on a strong demand for uniformity. We are interested in how accounting standards affect material harmonization and especially whether uniformity and comparability are improved. Since IFRS is a principles-based, rather than a rule-based, accounting regime it is not self-evident that the new standards will increase comparability significantly. Because the principles must be interpreted, and interpretations will vary, there is a possibility that the result will be a harmonization of principles but not necessarily a harmonization of accounting numbers (cf. Barth et al. 2012).[1] Looking at the discussion and analysis in the two preceding chapters, we can see that the demands for uniformity do not always lead to a situation in which financial accounting numbers can be compared across companies and industries (cf. Paul and Largay 2005). In the case of segment reporting, this is perhaps not the intention of the regulators but it will most likely be the effect. In other cases, such as financial instruments, the standards are extremely complicated, and that complexity gives companies some freedom in their accounting choices (cf. Carmona and Trombetta 2008; Alexander et al. 2012). However, such freedom does not automatically mean that companies will strive to "hide" information. Instead it can be a means to account for company activities in a

[1] It seems however that there is some evidence of increased comparability. Barth et al. (2012, p. 90) conclude: "Taken together, the findings suggest that efforts to converge accounting standards, the increasing mandatory use of IFRS throughout the world, the development of international auditing standards, and efforts to increase coordination of international securities market regulators have increased comparability of accounting amounts. However, although widespread application of IFRS by non-US firms has enhanced financial reporting comparability with US firms, significant differences remain."

way that "better" reflects their operations compared to a situation in which reporting is based on strict rules (cf. Messner 2009; Roberts 2009). That could increase transparency, though perhaps at the expense of comparability.

In conclusion our discussion has shown that the demands for uniformity affect financial accounting. Efforts to harmonize accounting standards have come a long way. As a result of three mechanisms of isomorphic change a new market-based accounting logic has been introduced (cf. DiMaggio and Powell 1983). By implementing fair value accounting and other accounting innovations, one aim has been to use the valuation models of the capital market as a basis in company reporting. To some extent it seems like this ambition has resulted in complex accounting standards and a mix of different valuation principles (a mix of fair values and historical costs). From our analysis, and as discussed in the preceding section, we can also observe that the effects of accounting standards are different depending on which type of standard and management control activity we are discussing. What is perhaps most interesting is that, on the one hand, financial accounting affects management control (see the preceding section) but at the same time management control also seems to affect financial accounting. This is most noticeable in segment reporting, but also in fair value accounting, for example, we can see that information from all parts of the management control process affects the financial accounts. Along similar lines, as in the discussion of the demands for uniqueness, we can also conclude that the combined effect of a specific standard is difficult to analyse. We can thus conclude that even though there are strong demands for uniformity and comparability in financial accounting, the implementation of IFRS is dependent on and also affected by the management control systems. In the next section we will discuss the tensions and conflicts between uniformity and uniqueness more in detail.

5.2.3 Tensions and Conflicts

In the "Relevance Lost" debate, the tensions and conflicts between financial accounting and management accounting (control) were discussed extensively (Johnson and Kaplan 1987). Even though there were many nuances in this debate, there seemed to be an overall agreement that financial accounting could possibly affect management control in a negative way (see Chap. 2 for a detailed discussion). However, the introduction of IFRS and the development of new and advanced IT systems (cf. Taipaleenmäki and Ikäheimo 2013) have shifted the opinion somewhat. Today there are a few studies in which the advantages of integrating financial accounting and management control are analysed. We have already discussed these studies in the preceding chapters, but it is worth repeating here that IFRS is considered to be an accounting regime which limits the information asymmetries between inside and outside stakeholders (Barlev and Haddad 2003; Haller and Eierle 2004). Especially in industries in which fair values of assets are of fundamental importance for operations, it could be expected that IFRS will influence

Table 5.1 Summary of the tensions and conflicts between financial accounting and management control

FA standards	MCS activities				
	Strategic planning	Budgeting	Reporting and analysis	Rewards and compensation	Impact (MCS ⇒ FA)/ tensions
Segment reporting	FA: 3	FA: 3	FA: 3	FA: 3	High/low to moderate
	MCS: 3	MCS: 3	MCS: 3	MCS: 3	
	Tensions: 1	Tensions: 2	Tensions: 2	Tensions: 2	
Goodwill accounting	FA: 2	FA: 3	FA: 1	FA: 2	Low to high/ low to moderate
	MCS: 3	MCS: 3	MCS: 2	MCS: 2	
	Tensions: 1	Tensions: 2	Tensions: 1	Tensions: 2	
Business combinations	FA: 2	FA: 2	FA: 1	FA: 2	Low to mod-erate/low to moderate
	MCS: 3	MCS: 2	MCS: 2	MCS: 2	
	Tensions: 1	Tensions: 2	Tensions: 1	Tensions: 2	
Fair value accounting	FA: 2	FA: 3	FA: 3	FA: 3	Moderate to high/moderate
	MCS: 3	MCS: 3	MCS: 3	MCS: 3	
	Tensions: 2	Tensions: 2	Tensions: 2	Tensions: 2	
Impact (FA ⇒ MCS)/ tensions	High/low to moderate	Moderate to high/ moderate	Moderate to high/low to moderate	Moderate to high/ moderate	

management control (Hemmer and Labro 2008). At the same time, as discussed by among others Miller and Power (2013), financial accounting and management control are based on different logics. That is the reason why most large companies, despite the very high costs, have two information systems. Thus, we can conclude that the reasoning so far has showed that the relationship between financial accounting and management control is more complicated than was previously anticipated. We will now look at these relationships and the possible tensions and conflicts in more detail.

To provide a summary and overview of the discussion and analysis in Chaps. 3 and 4, we have developed Table 5.1. The columns represent the different activities in the management control process (i.e. strategic planning, budgeting, reporting and analysis and finally rewards and compensation). The rows represent financial accounting standards (i.e. segment reporting, goodwill accounting, business combinations and fair value accounting).

For each combination of a management control activity and a financial accounting standard we have evaluated (a) the possible impact and (b) the possible tensions and conflicts using the scale: 1 = low impact/low tension and conflict; 2 = moderate impact/moderate tension and conflict; and finally 3 = high impact/high tension and conflict. In each box we use the abbreviation "FA" for how management control impacts financial accounting (the causal relationship: MCS ⇒ FA). The abbreviation "MCS" is used to show how financial accounting impacts management control

(the causal relationship FA $\Rightarrow$ MCS). Finally we use the abbreviation "Tensions" to indicate the strength of the potential conflict that the tension causes. The total effects for each management control activity, and for each financial accounting standard, is summarized at the bottom of each column and at the end of each row. Before we move on to make some overall comments on the table, we would like to underline that it should be treated as an explorative and tentative product only. It is based to a large extent on our own reasoning and must be validated in future empirical research. Nevertheless we think it has merit as starting point for such research and for an informed and continuing discussion of the tensions and conflicts between uniformity and uniqueness.

If we start with looking at how financial accounting can be expected to affect management control, we can tentatively conclude, from the Table 5.1 and previous discussion, that there is a moderate to high impact. Strategic planning is impacted the most, while the other three activities can be expected to be impacted to a somewhat lesser extent. Without doubt financial accounting affects management control, and that is also a conclusion that is fully in line with our expectations (see for example Jones and Luther 2005; Brandau et al. 2013; Miller and Power 2013). What is perhaps more surprising is that also financial accounting can be expected to be affected to a large degree. There are several possible explanations for this. First the accounting standards that we have discussed and analysed require a great deal of new information; especially information that is forward-looking and is used to make predictions (e.g. future cash-flows). That type of information is usually not contained within the financial accounting system but more likely within the management control system (cf. Langfield-Smith 2008). Since management control is more focused on mirroring what is happening right now and not on decisions made a long time ago, other types of information than historical cost are needed (see for example Taipaleenmäki and Ikäheimo 2013). That information must also be interpreted and translated to the language of financial accounting by managers and accountants. This leads us to the second explanation: that IFRS is an accounting-regime based on principles. That means that the principles are harmonized and a higher degree of uniformity will thereby result, which will eventually lead to increased comparability. However in practice a principles-based accounting regime will also lead to considerable leeway for executives and accountants to affect the accounting numbers (cf. Barth et al. 2012). Even though there is no intention to misrepresent the company in accounting terms, it is likely that management control will affect financial accounting. The reason is that a great deal of management control information will be used and translated by executives and accountants. In sum we can expect that financial accounting and management control affect one another. We will now discuss if, and to what extent, that can be expected to create tensions and conflicts.

In Table 5.1 the tensions vary between low to moderate. We have not been able to identify a probable "high tension" in any of the combinations of financial accounting and management control analysed. Some of these tensions have to do with the risk of a financially oriented and short-term accounting-regime "invading" the company, threatening to make the management control system less aligned with the strategies. In combination with senior executives refocusing their attention from the inside to how their activities are accounted for, this could lead to a situation in which the creation of value gets less attention than how this value-creation is reported. Such a development would have many similarities to the criticism levelled by Johnson and Kaplan (1987) in the "Relevance Lost" debate. Other tensions have to do with management control distorting financial accounting. As we discussed above, a high degree of integration of management control and financial accounting could also lead to a situation in which the former starts to affect the latter. As will be discussed in the next section, such a development is not necessarily bad. It could also make the financial accounts more transparent by a stronger alignment to the objectives and strategies of the corporation. In that way financial accounting would have a closer connection to how the board and senior executives manage the company (Barlev and Haddad 2003). The risk is, of course, that such a development leads to a situation in which comparability with other companies is affected in a negative way.

If we take a look at all accounting standards and control activities together, we can first of all conclude that there are many possible effects and that these effects—even when talking about only one combination in Table 5.1—do not always work in the same causal direction. It should also be observed that most of the accounting standards chosen for analysis do not affect all large companies and not to the same extent (cf. Mustata and Matis 2010). For example there are many large companies that do not make any acquisitions. Therefore the table should be used with great caution and only as an example of possible effects and tensions. Having said that, it is possible to conclude on an overall level that we will probably be able to observe low to moderate tensions and conflicts between financial accounting and management control in companies that have implemented IFRS. We also believe that these tensions and conflicts can be handled, not least if they receive proper attention. In this connection it is also important to once again stress the trend of creating integrated systems, such as integrated reporting (IIRC 2013), and also developing the necessary IT solutions for that type of system (cf. Rom and Rohde 2007). This development will hopefully lead to a situation in which both the advantages and disadvantages of integrated systems are discussed in greater detail.

5.3 Relevance Lost or Regained?

We will now revisit and reflect upon the conclusions presented around 25 years ago by Johnson and Kaplan (1987) against the backdrop of recent developments in international financial accounting and ask the question: is it still reasonable to

consider financial accounting a potential threat to management control relevance? The question is highly interesting considering the recent and fundamental changes to financial accounting and the ambition to create a single and uniform set of accounting standards. This ambition is instrumental in creating a global market where owners and funders can compare and analyse financial reporting data from different countries and make informed investment decisions.

Indeed, we concluded in the previous section that financial accounting is affecting management control. At the same time financial accounting standards are becoming more complex and based on senior executive judgement. Therefore it will not only be a matter of financial accounting affecting management control, but also a matter of management control affecting financial accounting. This reversed causal effect could lead to a new and unexpected answer to the overall question of whether management control has lost its relevance or regained it. Or, in other words, has management control regained its relevance with the introduction of IFRS?

Generally speaking, the growing importance of financial accounting is not surprising in itself. For example, fair value accounting has been discussed and developed by regulators and scholars since the mid nineteenth century. A more well-organised standard-setting process for financial accounting has also led to established and even institutionalised procedures (Georgiou and Jack 2011). It is therefore not surprising that the debate over the importance of financial accounting started in the 1980s. At that time, there were many changes to company reporting in general. Not least the rapid changes in financial accounting made management control appear somewhat obsolete. In sum, the background against which Johnson and Kaplan's debate was spurred was coloured by rapid changes in many respects and increased degrees of standardisation in financial accounting.

Looking only at the background to the debate, it is reasonable to assume that a similar debate today would have a somewhat different outset. The technological level of organization's information systems is much higher today than 25 years ago. Organizations are also much more used to changes and to updating their information systems regularly. It is no exaggeration to claim that change and adaptation has become a normal feature of organizational life. Also, the financial accounting standard-setting process has changed. Earlier, especially in the 1970s, it was directed mainly towards standardisation (Cortese 2011). Today, with an international body of financial accounting standards established, and with convergence processes taking place all over the world, the focus has been directed much more on principles, and the creation of a global set of financial accounting standards. Furthermore the ideas of for whom standards are developed has also changed. Today primary users are the capital-market participants, which posit the idea of usefulness outside the company rather than inside it (cf. Miller and Power 2013). Hence, the issue of relevance is more complex and is also connected to trends in society, such as a more developed and integrated financial market, a more global and standardised world and perhaps a little bit less room for uniqueness in general.

All of these developments, compared to the situation in the 1970s and 1980s, suggest that the "Relevance Lost" debate—if it were to be revisited—would be

different. So what could we expect from a possible "Relevance Lost" debate today? With the introduction of a global principles-based set of financial accounting standards, this question becomes intriguing once again, not least since regulators themselves stress that financial accounting standards should mirror internal decision-making to a greater extent than earlier, something that one might expect would increase the integration.

A recurring question in the "Relevance Lost" debate is what information is in fact most relevant for senior executives in making decisions? One stream of arguments is critical to the tendency of financial accounting to "invade" management control systems, and by doing so to define what type of information is most relevant to senior executives and other decision-makers. The reason for this is simple: as mentioned throughout the book a management control system should use information supporting the formulation and implementation of strategies. That information is unique to that particular company. However, what has also been argued is that the way that the organization is portrayed to the outside world is highly relevant also to decision-makers within the company. Therefore, senior executives often perceive management information needs in terms of how the organization is presented in the reporting format provided by financial accounting (Joseph et al. 1996).

In other words, it is not possible to entirely separate the portrayal of the organization to the outside world from the internal workings of that same organization. In that way, the convergence of financial accounting and management control is expected and has also been made possible not least because of advanced IT-systems being developed (Taipaleenmäki and Ikäheimo 2013). Also, since financial accounting is becoming even more regulated, it is important to have control over the information that constitutes the basis for both external and internal reports. The interest in integrated reporting can be seen as an example of efforts to create a coherent picture of the organization (cf. IIRC 2013). Given that external views of the organization cannot be entirely separated from or seen as not relevant for how the company is viewed internally, this integration may in fact increase the relevance of the management control system. This is pinpointed by the IASB, which says that what is relevant to external stakeholders, such as shareholders, should also be relevant to the company (Hjelström and Schuster 2011, p. 84).

One way of interpreting this view is to say that it is in line with the general trend of "value for money" as the only acceptable reason for the existence of all organizations in modern society (Brettell Grip 2009). An organization that cannot prove that it is adding value will have difficulty making a case for its existence. This has been particularly troublesome for arts organizations and other public organizations that have a hard time quantifying the value of their activities. Since their results are seldom seen in the short run, but may be built up over hundreds of years, challenges are likely to appear in relation to external stakeholders with a short-term view of value creation (Stockenstrand and Ander 2014). This leads us to conclude that the question of whether relevance is lost or regained is a matter of perspective, ultimately leading to the "relevant to whom?" question—a question that has been debated for example in the accountability literature (cf. Laughlin 1996; Joannides

2012). According to Östman (2009) the design and use of information systems are affected by the stakeholders' view of to whom, or what, they are accountable. Östman (2009) distinguishes between two different kinds of organizations, one function-driven and the other pay-driven. Depending on what drives the organization, the management control system should be designed and used differently.

In this book, we have looked in particular into some financial accounting changes that is a result of the introduction of IFRS. These standards apply to large listed companies and it is therefore not unreasonable to expect that the interests of owners and funders should guide the design and use of accounting and control in companies following IFRS. This is also something that has been emphasized by the IASB when it says that information that is relevant to shareholders should also be relevant to companies following IFRS. However, even though the overall objective of these companies is to make a profit and should do what is in the best interest of shareholders, the companies may still have different objectives and strategies.

In conclusion, there seem to be a tendency to see advantages, and a regained relevance, in the integration of financial accounting and management control. Financial accounting standard setters also increasingly depart from the management control system and the information used there, in order to define what is relevant also in the financial reporting. In this book we have given a number of examples, and discussed the possible effects with regard to different parts of the management control system. One of our overall conclusions is that management control seems to have regained its relevance. Another conclusion is that financial accounting seems to be losing some of its relevance. At the same time the term "relevance" in the financial accounting domain is ambiguous—it has to do with mirroring what is actually happening within a company to the outside world, what strategies the company is pursuing and how decision-making is done internally. However, relevance in financial accounting is also about comparability and some degree of uniformity. Classification theory has described the fundamental need for uniformity as a tool for understanding the world. By systematically lumping and splitting the world into categories, simplicity can be achieved, which in turn can lead to an increased understanding of company performance (cf. Starr 1992). The need for classification to understand one thing in relation to another is a driving force for uniformity.

Our discussion and analysis show that financial accounting classifications are far from simple. Classifications in financial accounting can only come about by bringing certain objects together based on a specific attribute or several attributes. But for this to happen, the number of relevant attributes of one specific object must be reduced, in order for a coherent image to appear. By using means of quantification, the qualities of a company's activities are transferred into accounting numbers and in turn are made comparable with other activities that are always in some respect different, though still comparable by reduction (Miller 2001). What seems to have happened with the introduction of a set of principles-based and complex financial accounting standards, relying heavily on the management's own judgement and view of the world, is that classifications are indeed made, but that the

attributes given to each class is different from company to company. Departing from the company's management control system and unique situation, it must be taken into account that there are an infinite number of attributes that each object can have (Roberts 1995). And it is not unlikely that financial accounting, in that process, is in fact losing relevance as a means of reaching uniformity and comparability between organizations. On the other hand, financial accounting can gain relevance by making external reporting more adapted to the unique situation of the company. Such a development can lead to a more informed analysis of how the company creates value and how competitive it is. Relevance is thus as an elusive concept, depending on from whose perspective it is discussed.

5.4 Conclusions and Implications

This book is about financial accounting and management control and how these two information systems are related, as well as their conflicting objectives. At a very general level they have some characteristics that are similar such as their use for evaluating past performance and make capital resource allocations. But even at this fundamental level there are also significant and important differences. The most noticeable one is the different objectives of the systems. As we discuss at length in all chapters the management control system is used in the strategic, tactical and operational decision-making process to ensure that the company is creating a competitive position in the market place. Financial accounting is used for evaluating value creation and whether the company is competitive. In the words of Miller and Power (2013) the former is based on a managerial logic and the latter on capital-market logic, hence the principal stakeholders are different. Management control should satisfy the information needs of the board, the senior executives and the employees, and financial accounting should satisfy the needs of owners and funders. Therefore it is not surprising that there will be tensions and even conflicts between the two information systems.

To understand and be able to analyse the tensions and conflicts we talk about "demands for uniformity" and "demands for uniqueness". Using analytical concepts, arguments and insights from principal-agent theory and institutional theory we discuss and analyse the isomorphic forces affecting financial accounting as well as management control. Contingency theory provides us with the analytical concepts to discuss and analyse how management control is aligned to the specific needs of the company (i.e. the unique strategy being pursued); in other words a counterforce to the pressure for conformity. Our ambition is to make a contribution beyond simplistic notions taking their departure from either a standpoint that the existence of different information systems means that they serve totally different purposes or an argument based on the desire to have one integrated information system that will provide a coherent picture to all stakeholders. We argue that both these standpoints are naïve and that neither of them is entirely correct though not entirely wrong either. However, both are needed since they capture the essence of

why there is—and probably should be—tensions and conflicts between financial accounting and management control.

One argument for uniformity, often put forward by regulators, is that owners and funders have information needs that are closely related to the needs of senior executives and other internal stakeholders. They seem to believe that the information used for evaluating value creation and the competitive position of the company is the same as the information that is needed to create value and competitiveness. To some extent this is a correct assumption, but it is also important to remember that information used for management purposes is less aggregated and mixes both financial and non-financial information—to just name a couple of differences. In addition, financial accounting is often accused of being much more short-term and financially orientated, which does not always lie in the best interest of the long-term development of the company. For example, studies using contingency theory has shown that a short-term, financially oriented management control system is not very suitable for companies pursuing a differentiation strategy. Even though owners and funders are aware of this, they do not have much influence over a global accounting regime and are also probably not knowledgeable regarding the consequences that such regime will have on the management control systems. As this book shows, these consequences are far from self-evident and are also sometimes surprising.

Based on our analysis we can conclude that financial accounting affects management control and vice versa. For example, the ambition of regulators to enable owners and funders to gain better insights into plans and performance, through a new way of reporting segments, could affect the strategies as well as the internal structures for decision-making. The same is true for goodwill accounting, business combinations and financial instruments, in which a more extensive use of fair values and forward-looking information could prompt management control systems to make more use of external data. With regard to reward and compensation issues, we conclude that, on the one hand, increased transparency could mean greater pressure on decision-makers within the company. However, with principles-based accounting standards, managers will also have greater scope for manoeuvring in their reporting, something that could be used to the benefit of senior executives. The sheer volume of information that is to be reported, and the need to use more internal information in financial accounting, will probably lead to even more investments in new or modified IT systems. In line with earlier research we can also expect that the integration of financial accounting and management control is facilitated by the development of more advanced IT systems.

Paradoxically, our analysis also indicates that a principles-based accounting regime can lead to situation in which there is a harmonisation of principles but not necessarily of accounting information as such. How this "flexibility" in financial accounting is dealt with will affect the tensions and conflicts identified in our framework. We have discussed it as a two-way process, where we find it likely that financial accounting will affect the management control systems of companies, but that we also see increased scope for internal forces to be more decisive in financial accounting. This conclusion leads us to the intriguing question of whether it is financial accounting, rather than management control that is starting to "lose" its

relevance. There are indications that we are observing a reverse effect compared to what was debated by Johnson and Kaplan in 1987. In contrast to the objectives of the efforts to harmonize financial accounting, and research reporting of an increased level of material harmonization (Mustata and Matis 2010), it seems that the annual reports are still difficult to compare—even between companies in the same industry. Such a development is not necessarily bad. It could lead to a situation in which the financial accounts become more relevant and useful for understanding the company and how it develops over time. Another advantage is that the management control system, which is intended to provide information about strategy implementation and value creation, can be used to provide information also for external stakeholders. With such a perspective it would be appropriate to say that even though the effects of IFRS on comparability are not totally clear, the introduction of IFRS still has the potential to increase the relevance of financial accounting, at least if the focus is on understanding and evaluating a specific company.

Finally, we would like to discuss some practical and theoretical implications. At the level of practice the book can help regulators, and other stakeholders influencing the development and implementation of accounting standards, to understand how financial accounting affects how companies are managed and controlled. Our analysis shows, and in line with earlier research, that financial accounting is not a neutral mirror but a force from the "outside" with the potential to change control systems and ultimately the behaviour of the board and senior executives. At the same time regulators can also increase their understanding for how management control affects financial accounting, making it less, or perhaps even more, relevant. The board and senior executives will also become more aware of how the complex package of management control activities is not only affected by the strategies of the company but also by accounting standards. To realize the huge complexity of these two information systems and how they are related is valuable in itself. It is also important to understand that this complexity cannot be entirely solved and that there will always be tensions and conflicts. Therefore it is not self-evident that the only way forward is to strive for an integration of financial accounting and management control. Nor is a de-coupling of the two information systems probably a viable option (cf. Meyer and Rowan 1977; Bromley and Powell 2012). Even though the book does not provide the practitioner with any definitive answers to this type of fundamental questions (e.g. integration or not) we hope that it can be a help in *asking* the "right" questions when making decisions about how to design and use information systems.

At the level of theory we can conclude that it has been fruitful to use insights and analytical concepts from contingency, principal-agent and institutional theory in our analysis and discussions. We have been able to study the conflict between uniformity and uniqueness in a way that we believe would not have been possible using only one of these theories. This is in line with other studies combining insights from different theoretical perspectives (e.g. Eisenhardt 1988; Volberda et al. 2012). Even though the aim of this book has not been to develop these theories, but instead to use them as our theoretical lens, we have nevertheless made some observations that could be used in further research. First, we believe

that studies of contingency relationships could benefit from also including how financial accounting affects the alignment of strategies and management control systems. Lately contingency researchers have started to study how corporate strategies affect control systems at lower organizational levels, but not how demands in the form of a global accounting regime, affect the corporate level. We believe that such a research design could shed some new light on the many ambiguous results within the contingency research paradigm. That type of studies could also contribute to the advancement of our understanding of counterforces, such as the alignment of strategies and control systems, to the strong isomorphic pressure from financial accounting standards. We need to know more about how different logics—economic, managerial, as well as logics not rooted in the search for efficiency (e.g. to gain legitimacy)—affect financial accounting and management control. In addition we would like to see research on how the tensions and conflicts are handled: will new IT solutions contribute to resolving the tensions and result in an integration between financial accounting and management control (cf. Taipaleenmäki and Ikäheimo 2013) or will there be some sort of decoupling between the two information systems (cf. Meyer and Rowan 1977; Oliver 1991)? New insights could also be gained regarding why PA theory and the focus on accountability and transparency have become so influential in the design of both financial accounting and management control systems. By conducting empirical studies with a design like this, it would also be possible to extend and further develop the framework and the preliminary conclusions that we have presented in this book.

To conclude we would like to stress something that we hope is evident by now: that this is a very interesting and highly relevant research area—also from the perspective of practitioners. The conflict between uniformity and comparability is an "eternal question" in which there are no definitive or final answers. Despite the complexity of this fundamental question, the process of writing the book has led us to believe that the relevance of financial accounting is at least as important as its uniformity and ultimately its comparability. There are reasons to believe that a stronger focus on relevance should also lead to increased transparency, since the financial accounts would be more aligned with the unique situation of the company and how it creates value. Financial accounts that are relevant, mirroring the uniqueness of the company, would also be easier to integrate with the management control system. We do not believe, however, that these two information systems should be totally integrated. They will always have separate and partly conflicting objectives. We must therefore accept that there will always be tensions and even conflicts. Perhaps, we should even start to focus more on what these tensions and conflicts could tell us about the company and its position on the product- and capital-markets.

References

ABA. (2010). *Classification and measurement of financial assets and liabilities, ABA comment letter 1 of 3 for file reference 1810-100*. https://www.aba.com/aba/documents/TaxAcct/ClassificationandMeasurement083110.pdf (Accessed January 15, 2014).

Ahrens, T., & Chapman, C. S. (2007). Management accounting as practice. *Accounting, Organizations and Society, 32*, 1–27.

Albu, N., & Albu, C. N. (2012). Factors associated with the adoption and use of management accounting techniques in developing countries: The case of Romania. *Journal of International Financial Management & Accounting, 23*, 245–276.

Alexander, D., Bonaci, C. G., & Mustata, R. V. (2012). Fair value measurement in financial reporting. *Procedia Economics and Finance, 3*, 84–90.

Anderson, H., Havila, V., & Nilsson, F. (2013). A stakeholder approach to mergers and acquisitions. In H. Anderson, V. Havila, & F. Nilsson (Eds.), *Mergers and acquisitions: The critical role of stakeholders* (pp. 1–14). New York: Routledge.

Anthony, R. N. (1965). *Planning and control systems: A framework for analysis*. Boston: Division of Research, Graduate School of Business Administration, Harvard University.

Anthony, R. N., Dearden, J., & Bedford, N. M. (1989). *Management control systems* (6th ed.). Homewood: Irwin.

Anthony, R. N., & Govindarajan, V. (2004). *Management control systems* (11th ed.). Boston: McGraw-Hill/Irwin.

Anthony, R. N., & Govindarajan, V. (2007). *Management control systems* (12th ed.). Boston: McGraw-Hill/Irwin.

Anthony, R. N., Govindarjan, V., Hartmann, F. G., Kraus, K., & Nilsson, G. (2014). *Management control systems*. London: McGraw-Hill Education.

Archer, S., & Otley, D. (1991). Strategy, structure, planning and control systems and performance evaluation – Rumenco Ltd. *Management Accounting Research, 2*, 263–303.

Arwinge, O. (2011). *Internal control: A study of concept and themes*. Heidelberg: Physica.

Arwinge, O. (2014). *Internal control in the financial sector: A longitudinal case study of an insurance company*. Doctoral thesis no. 167, Department of Business Studies, Uppsala University, Uppsala.

Baboukardos, D., & Rimmel, G. (2014). Goodwill under IFRS: Relevance and disclosures in an unfavorable environment. *Accounting Forum, 38*, 1–17.

Barlev, B., & Haddad, J. R. (2003). Fair value accounting and the management of the firm. *Critical Perspectives on Accounting, 14*, 383–415.

Barth, M. E., & Landsman, W. R. (2010). How did financial reporting contribute to the financial crisis? *European Accounting Review, 19*, 399–423.

© Springer International Publishing Switzerland 2015
F. Nilsson, A.-K. Stockenstrand, *Financial Accounting and Management Control*, Contributions to Management Science, DOI 10.1007/978-3-319-13782-7

Barth, M. E., Landsman, W. R., Lang, M., & Williams, C. (2012). Are IFRS-based and US GAAP-based accounting amounts comparable? *Journal of Accounting and Economics, 54*, 68–93.

Beattie, V., Fearnley, S., & Hines, T. (2008). Does IFRS undermine UK reporting integrity? *Accountancy, 142*, 56–57.

Beresford, D. R. (2001). Congress looks at accounting for business combinations. *Accounting Horizon, 15*, 73–86.

Bhimani, A., & Soonawalla, K. (2005). From conformance to performance: The corporate responsibilities continuum. *Journal of Accounting and Public Policy, 24*, 165–174.

Borglund, T., De Geer, H., Sweet, S., Frostenson, M., Lerpold, L., Nordbrand, S., Sjöström, E., & Windell, K. (2012). *CSR – Corporate social responsibility: En guide till företagets ansvar*. Stockholm: Sanoma Utbildning.

Brandau, M., Endenich, C., Trapp, R., & Hoffjan, A. (2013). Institutional drivers of conformity – evidence for management accounting from Brazil and Germany. *International Business Review, 22*, 466–479.

Brettell Grip, A.-K. (2009). *Funding and accountability: Studies of a Swedish and a British chamber orchestra*. Dissertation, EFI, Stockholm.

Bromley, P., & Powell, W. W. (2012). From smoke and mirrors to walking the talk. Decoupling in the contemporary world. *The Academy of Management Annals, 6,* 483–530.

Bromwich, M., & Bhimani, A. (1989). *Management accounting: Evolution not revolution*. London: CIMA.

Bromwich, M., & Bhimani, A. (1994). *Management accounting: Pathways to progress*. London: CIMA.

Brown, R., & Sarma, N. (2007). CEO overconfidence, CEO dominance and corporate acquisitions. *Journal of Economics and Business, 59*, 358–379.

Burns, J., & Scapens, R. W. (2000). Conceptualizing management accounting change: An institutional framework. *Management Accounting Research, 11*, 3–25.

Burns, T., & Stalker, G. M. (1961). *The management of innovation*. London: Tavistock.

Canning, M., & O'Dwyer, B. (2013). The dynamics of a regulatory space realignment: Strategic responses in a local context. *Accounting, Organizations and Society, 38,* 169–194.

Cañibano, L., & Mora, A. (2000). (cited in Mustata and Matis 2010) Evaluating the statistical significance of de facto accounting harmonization: A study of European global players. *The European Accounting Review, 9*, 349–369.

Carmona, S., & Trombetta, M. (2008). On the global acceptance of IAS/IFRS accounting standards: The logic and implications of the principles-based system. *Journal of Accounting and Public Policy, 27*, 455–461.

Carnes, G. A., & Guffey, D. M. (2000). The influence of international status and operating segments on firms' choice of bonus plans. *Journal of International Accounting, Auditing and Taxation, 9*, 43–57.

Chapman, C. S. (1997). Reflections on a contingent view of accounting. *Accounting, Organizations and Society, 22*, 189–205.

Chatham, M. D., Larson, R. K., & Vietze, A. (2010). Issues affecting the development of an international accounting standard on financial instruments. *Advances in Accounting, incorporating Advances in International Accounting, 26*, 97–107.

Chen, C. R., Steiner, T. L., & Whyte, A. M. (2006). Does stock option-based executive compensation induce risk-taking? An analysis of the banking industry. *Journal of Banking & Finance, 30*, 915–945.

Choi, F. D. S., & Meek, G. K. (2005). (cited in Jermakowicz and Gornik-Tomaszewski 2006) *International accounting* (5th ed.). Upper Saddle River: Prentice Hall.

Clark, J. M. (1923). (cited in Joseph et al. 1996) *Studies in the economics of overhead costs*. Chicago: The University of Chicago Press.

Cooper, R., & Kaplan, R. S. (1997). *Cost & effect: Using integrated cost systems to drive profitability and performance*. Boston: Harvard Business School Press.

Cooper, R., & Kaplan, R. S. (1998). The promise – and peril – of integrated cost systems. *Harvard Business Review, 76*, 109–119.

Cortese, C. (2011). Standardizing oil and gas accounting in the US in the 1970s: Insights from the perspective of regulatory capture. *Accounting History, 16*, 403–421.

Coupland, C. (2006). Corporate social and environmental responsibility in web-based reports: Currency in the banking sector. *Critical Perspectives on Accounting, 17*, 865–881.

Crawford, J., Kashyap, S., Nilsson, F., Stockenstrand, A.-K., & Tirmén, M. (2014). *Accounting and control in banks. A literature review*. Working paper presented at a workshop on effects of external demands in the banking sector hosted by Fredrik Nilsson and Anna-Karin Stockenstrand, 11–12 February, 2014, Uppsala, Sweden.

Cuganesan, S., Dunford, R., & Palmer, I. (2012). Strategic management accounting and strategy practices within a public sector agency. *Management Accounting Research, 23*, 245–260.

Davidson, S. (1963). (cited in Kaplan 1984) The day of reckoning – managerial analysis and accounting theory. *Journal of Accounting Research, 1*, 117–126.

De Franco, G., Kothari, S. P., & Verdi, R. S. (2011). The benefits of financial statement comparability. *Journal of Accounting Research, 49*, 895–931.

Dechow, N., Granlund, M., & Mouritsen, J. (2007). Management control of the complex organization: Relationships between management accounting and information technology. In C. S. Chapman, A. G. Hopwood, & M. D. Shields (Eds.), *Handbook of management accounting research* (Vol. 2, pp. 625–640). Amsterdam: Elsevier.

Deloitte. (2004). *Business combinations: A guide to IFRS 3*. http://www.casplus.com/pubs/files/ifrs3.pdf (Accessed September 10, 2014).

DeMarzo, P. M., & Duffie, D. (1995). Corporate incentives for hedging and hedge accounting. *The Review of Financial Studies, 8*, 743–771.

Detzen, D., & Zülch, H. (2012). Executive compensation and goodwill recognition under IFRS: Evidence from European mergers. *Journal of International Accounting, Auditing and Taxation, 21*, 106–126.

DiMaggio, P. J., & Powell, W. W. (1983). The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields. *American Sociological Review, 48*, 147–160.

Donovan, J., Tully, R., & Wortman, B. (1998). *The value enterprise: Strategies for building a value-based organization*. Toronto: McGraw-Hill.

Drury, C., & Tayles, M. (1997). Evidence on the financial accounting mentality debate: A research note. *British Accounting Review, 29*, 263–276.

Dugdale, D., & Jones, T. C. (2003). Battles in the costing war: UK debates, 1950–75. *Accounting Business and Financial History, 13*, 305–338.

EAA. (2005). Comment letter on the exposure draft of proposed amendments to IFRS 3 Business combinations (submitted by Jan Marton).

Eccles, R. G. (1991). The performance measurement manifesto. *Harvard Business Review, 69*, 131–137.

Eccles, R. G., & Krzus, M. P. (2010). Integrated reporting for a sustainably strategy. *Financial Executive, 26*, 28–32.

Edvinsson, L., & Malone, M. S. (1997). *Intellectual capital: Realizing your company's true value by finding its hidden brainpower*. New York: Harper Business.

Eierle, B., & Schultze, W. (2013). The role of management as a user of accounting information: Implications for standard setting. *Accounting and Management Information Systems, 12*, 155–189.

Eisenhardt, K. M. (1988). Agency- and institutional-theory explanations: The case of retail sales compensation. *Academy of Management Journal, 31*, 488–511.

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *Academy of Management Review, 14*, 57–74.

ESMA. (2013, January). *ESMA report: European enforcers review of impairment of goodwill and other intangible assets in the IFRS financial statements*. http://www.esma.europa.eu/system/files/2013-02.pdf (Accessed September 10, 2014).

European Commission. (2008, November 24). *Endorsement of revised IFRS 3 business combinations and amended IAS 27 consolidated and separate financial statements: Introduction, background and conclusions*. Brussels. http://ec.europa.eu/internal_market/accounting/docs/ias27_business_combinations_en.pdf (Accessed January 9, 2014).

Ewert, R., & Wagenhofer, A. (2007). Management accounting theory and practice in German-speaking countries. In C. S. Chapman, A. G. Hopwood, & M. D. Shields (Eds.), *Handbook of management accounting research* (Vol. 2, pp. 1035–1069). Amsterdam: Elsevier.

Ezzamel, M., Hoskin, K., & Macve, R. (1990). Managing it all by numbers: A review of Johnson & Kaplan's 'Relevance Lost'. *Accounting and Business Research, 20*, 153–166.

FAF. (2013, May). *Post-implementation review report on FASB statement No. 141 (revised 2007) business combinations*. http://www.accountingfoundation.org/cs/BlobServer?blobkey=id&blobwhere=1175826970387&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs (Accessed December 12, 2013).

FASB. (2014). *Project update: Accounting for financial instruments—Joint project of the FASB and IASB*. http://www.fasb.org/fi_improvements_to_recognition_and_measurement.shtml#background (Accessed January 12, 2014).

Frostenson, M., Helin, S., & Sandström, J. (2012). *Hållbarhetsredovisning: Grunder, praktik och funktion*. Malmö: Liber.

Garrido, P., León, Á., & Zorio, A. (2002). Measurement of formal harmonization progress: The IASC experience. *The International Journal of Accounting, 37*, 1–26.

Georgiou, O., & Jack, L. (2011). In pursuit of legitimacy: A history behind fair value accounting. *The British Accounting Review, 43*, 311–323.

Gerdin, J., & Greve, J. (2004). Forms of contingency fit in management accounting research – a critical review. *Accounting, Organizations and Society, 29*, 303–326.

Gerdin, J., & Greve, J. (2008). The appropriateness of statistical methods for testing contingency hypotheses in management accounting research. *Accounting, Organizations and Society, 33*, 995–1009.

Giddens, A. (1979). (cited in DiMaggio and Powell 1983) *Central problems in social theory: Action, structure and contradiction in social analysis*. Berkeley: University of California Press.

Goold, M., Campbell, A., & Alexander, M. (1994). *Corporate-level strategy: Creating value in the multibusiness company*. New York: Wiley.

Govindarajan, V. (1988). A contingency approach to strategy implementation at the business unit level: Integrating administrative mechanisms with strategy. *Academy of Management Journal, 31*, 828–853.

Gupta, P. P., Dirsmith, M. W., & Fogarty, T. J. (1994). Coordination and control in a government agency: Contingency and institutional theory perspectives on GAO audits. *Administrative Science Quarterly, 39,* 264–284.

Haller, A., & Eierle, B. (2004). The adaptation of German accounting rules to IFRS: A legislative balancing act. *Accounting in Europe, 1*, 27–50.

Handelsbanken. (2013). *Årsredovisning 2013.*

Hawley, A. (1968). (cited in DiMaggio and Powell 1983) Human ecology. In D. L. Sills (Ed.), *International encyclopedia of the social sciences* (pp. 328–337). New York: Macmillan.

Hayes, R. H., & Abernathy, W. J. (1980). Managing our way to economic decline. *Harvard Business Review, 58*, 67–77.

Hayward, M. L. A., & Hambrick, D. C. (1997). Explaining the premiums paid for large acquisitions: Evidence of CEO hubris. *Administrative Science Quarterly, 42*, 103–127.

Hellman, N. (2011). Soft adoption and reporting incentives: A study of the impact of IFRS on financial statements in Sweden. *Journal of International Accounting Research, 10*, 61–83.

Hemmer, T., & Labro, E. (2008). On the optimal relation between the properties of managerial and financial reporting systems. *Journal of Accounting Research, 46*, 1209–1240.

Hines, R. D. (1988). Financial accounting: In communicating reality, we construct reality. *Accounting, Organizations and Society, 13*, 251–261.

Hjelström, A., & Schuster, W. (2011). Standards, management incentives and accounting practice – lessons from the IFRS transition in Sweden. *Accounting in Europe, 8*, 69–88.

Hodder, L. D., & Hopkins, P. E. (2014). Agency problems, accounting slack, and banks' response to proposed reporting of loan fair values. *Accounting, Organizations and Society, 39*, 117–133.

Hope, J., & Fraser, R. (2003). *Beyond budgeting: How managers can break free from the annual performance trap*. Boston: Harvard Business School Press.

Hopper, T., Kirkham, L., Scapens, R. W., & Turley, S. (1992). Does financial accounting dominate management accounting – a research note. *Management Accounting Research, 3*, 307–311.
Hughes, H. P. (1982). *Goodwill in accounting: A history of the issues and problems* (Research Monograph No. 80). Atlanta, GA: College of Business Administration, Georgia State University.
IAA. (2007). *Internal auditing: Assurance consulting services*. Altamonte Springs: The IIA Research Foundation.
IFRS Foundation. (2013a, July). *Post-implementation review: IFRS 8 operating segments. Report and feedback statement*. http://www.ifrs.org/Current-Projects/IASB-Projects/PIR/IFRS-8/Documents/PIR-IFRS-8-Operating-Segments-July-2013.pdf (Accessed June 17, 2014).
IFRS Foundation. (2013b, July). *Staff paper, IASB agenda ref 12, post implementation review – IFRS 3 business combinations*. http://www.ifrs.org/Meetings/MeetingDocs/IASB/2013/July/12-Post-implementation%20Review.pdf (Accessed December 12, 2013).
IFRS Foundation. (2014, July). Project summary: IFRS 9 financial instruments. http://www.ifrs.org/Current-Projects/IASB-Projects/Financial-Instruments-A-Replacement-of-IAS-39-Financial-Instruments-Recognitio/Documents/IFRS-9-Project-Summary-July-2014.pdf (Accessed January 12, 2015).
IIRC. (2013). *The international < IR > Framework*.
Ikäheimo, S., & Taipaleenmäki, J. (2010). The divergence and convergence of financial accounting and management accounting: Institutional analysis of the U.S., Germany and Finland. *Die Betriebswirtschaft, 70*, 349–368.
Jannesson, E., Nilsson, F., & Rapp, B. (Eds.) (2014). *Strategy, control and competitive advantage: Case study evidence*. Springer-Verlag Berlin Heidelberg.
Jemison, D. B., & Sitkin, S. B. (1986). Corporate acquisitions: A process perspective. *Academy of Management Review, 11*, 145–163.
Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3*, 305–360.
Jermakowicz, E. K., & Gornik-Tomaszewski, S. (2006). Implementing IFRS from the perspective of EU publicly traded companies. *Journal of International Accounting, Auditing and Taxation, 15*, 170–196.
Joannides, V. (2012). Accounterability and the problematics of accountability. *Critical Perspectives on Accounting, 23*, 244–257.
Johnson, H. T., & Kaplan, R. S. (1987). *Relevance lost: The rise and fall of management accounting*. Boston: Harvard Business School Press.
Jones, C. S. (1985a). An empirical study of the role of management accounting systems following takeover or merger. *Accounting, Organizations and Society, 10*, 177–200.
Jones, C. S. (1985b). An empirical study of the evidence for contingency theories of management accounting systems in conditions of rapid change. *Accounting, Organizations and Society, 10*, 303–328.
Jones, T. C., & Luther, R. (2005). Anticipating the impact of IFRS on the management of German manufacturing companies: Some observations from a British perspective. *Accounting in Europe, 2*, 165–193.
Joseph, N., Turley, S., Burns, J., Lewis, L., Scapens, R., & Southworth, A. (1996). External financial reporting and management information: A survey of U.K. management accountants. *Management Accounting Research, 7*, 73–93.
Judge, W., Li, S., & Pinsker, R. (2010). National adoption of international accounting standards: An institutional perspective. *Corporate Governance: An International Review, 18*, 161–174.
Jørgensen, B., & Messner, M. (2010). Accounting and strategising: A case study from new product development. *Accounting, Organizations and Society, 35*, 184–204.
Kald, M., Nilsson, F., & Rapp, B. (2000). On strategy and management control: The importance of classifying the strategy of the business. *British Journal of Management, 11*, 197–212.
Kam, V. (1990). *Accounting theory* (2nd ed.). New York: Wiley.
Kaplan, R. S. (1984). The evolution of management accounting. *The Accounting Review, 59*, 390–418.
Kaplan, R. S., & Norton, D. P. (1992). The balanced scorecard: Measures that drive performance. *Harvard Business Review, 70*, 71–79.

Kaplan, R. S., & Norton, D. P. (1996). *The balanced scorecard: Translating strategy into action*. Boston: Harvard Business School Press.

Kaplan, R. S., & Norton, D. P. (2001). *The strategy-focused organization: How balanced scorecard companies thrive in the new business environment*. Boston: Harvard Business School Press.

Kaplan, R. S., & Norton, D. P. (2004). *Strategy maps: Converting intangible assets into tangible outcomes*. Boston: Harvard Business School Press.

Kavitha, W., & Anita, P. (2011). Disclosures about CSR practices: A literature review. *IUP Journal of Corporate Governance, 10*, 45–55.

Ketokivi, M. A., & Schroeder, R. G. (2004). Strategic, structural contingency and institutional explanations in the adoption of innovative manufacturing practices. *Journal of Operations Management*, 22, 63–89.

Knutsen, S., & Lie, E. (2002). Financial fragility, growth strategies and banking failures: The major Norwegian banks and the banking crisis. *Business History, 44*, 88–111.

Kothari, S. P., & Lester, R. (2012). The role of accounting in the financial crisis: Lessons for the future. *Accounting Horizons, 26*, 335–351.

KPMG. (2011). *KPMG international survey of corporate social responsibility reporting 2011*. Amsterdam: KPMG.

Lambert, R. A. (2007). Agency theory and management accounting. In C. S. Chapman, A. G. Hopwood, & M. D. Shields (Eds.), *Handbook of management accounting research* (Vol. 1, pp. 247–268). Amsterdam: Elsevier.

Langfield-Smith, K. (2007). A review of quantitative research in management control systems and strategy. In C. S. Chapman, A. G. Hoopwood, & M. D. Shields (Eds.), *Handbook of management accounting research* (Vol. 2, pp. 753–783). Amsterdam: Elsevier.

Langfield-Smith, K. (2008). Strategic management accounting: How far have we come in 25 years? *Accounting, Auditing and Accountability Journal, 21*, 204–228.

Laskaridou, E. C., & Athanasios, V. (2013). Detecting asset impairment management: Some evidence from food and beverage listed companies. *Procedia Technology, 8*, 493–497.

Laughlin, R. (1996). Principals and higher principals: Accounting for accountability in the caring professions. In R. Munro & J. Mouritsen (Eds.), *Accountability: Power, ethos and the technologies of managing*. London: International Thompson Press.

Laux, C., & Leuz, C. (2009a). *Did fair-value accounting contribute to the financial crisis?* (NBER Working Paper Series, working paper 15515). http://www.nber.org/papers/w15515 (Accessed September 11, 2014).

Laux, C., & Leuz, C. (2009b). The crisis of fair-value accounting: Making sense of the recent debate. *Accounting, Organizations and Society, 34*, 826–834.

Lawrence, P. R., & Lorsch, J. W. (1967). *Organization and environment: Managing differentiation and integration*. Boston: Division of Research, Graduate School of Business Administration, Harvard University.

Lindsay, R. M., & Libby, T. (2007). Svenska Handelsbanken: Controlling a radically decentralized organization without budgets. *Issues in Accounting Education, 22*, 625–640.

Livne, G., Markarian, G., & Milne, A. (2011). Bankers' compensation and fair value accounting. *Journal of Corporate Finance, 17*, 1096–1115.

Magnan, M., & Markarian, G. (2011). Accounting, governance and the crisis: Is risk the missing link? *European Accounting Review, 20*, 215–231.

Malmi, T., & Brown, D. A. (2008). Management control systems as a package – Opportunities, challenges and research directions. *Management Accounting Research, 19*, 287–300.

McNair, C. J., Lynch, R. L., & Cross, K. F. (1990). Do financial and nonfinancial performance measures have to agree? *Management Accounting, November*, 28–36.

Messner, M. (2009). The limits of accountability. *Accounting, Organizations and Society, 34*, 918–938.

Meyer, J. W., & Rowan, B. (1977). Institutionalized organizations: Formal structure as myth and ceremony. *The American Journal of Sociology, 83*, 340–363.

Mikes, A. (2009). Risk management and calculative cultures. *Management Accounting Research, 20*, 18–40.

Mikes, A. (2011). From counting risk to making risk count: Boundary-work in risk management. *Accounting, Organizations and Society, 36*, 226–245.

Miller, P. (2001). Governing by numbers: Why calculative practices matter. *Social Research, 68*, 379–396.

Miller, P., & Power, M. (2013). Accounting, organizing, and economizing: Connecting accounting research and organization theory. *The Academy of Management Annals, 7*, 557–605.

Mintzberg, H. (1987). The strategy concept I: Five Ps for strategy. *California Management Review, 30*, 11–24.

Mintzberg, H. (2000). *The rise and fall of strategic planning*. London: Prentice Hall.

Mintzberg, H., Ahlstrand, B., & Lampel, J. (1998). *Strategy safari. A guided tour through the wilds of strategic management*. London: Prentice Hall.

Murphy, J. (1990, April). (cited in Ong 2003) Brand valuation – not just an accounting issue. *ADMAP*, pp. 36–41.

Mustata, R. V., & Matis, D. (2010). Systems for material harmonization measurement within the changing global accounting environment: A review. *Journal of Organisational Transformation and Social Change, 7*, 47–87.

Nichols, N. B., Street, D. L., & Cereola, S. J. (2012). An analysis of the impact of adopting IFRS 8 on the segment disclosures of European blue chip companies. *Journal of International Accounting, Auditing and Taxation, 21*, 79–105.

Nichols, N. B., Street, D. L., & Tarca, A. (2013). The impact of segment reporting under the IFRS 8 and SFAS 131 management approach: A research review. *Journal of International Financial Management and Accounting, 24*, 261–312.

Nilsson, F. (2002). Strategy and management control systems: A study of the design and use of management control systems following takeover. *Accounting and Finance, 42*, 41–71.

Nilsson, F., Olve, N.-G., & Arwinge, O. (2013). The internal auditor's involvement in acquisitions. In H. Anderson, V. Havila, & F. Nilsson (Eds.), *Mergers and acquisitions: The critical role of stakeholders* (pp. 101–122). New York: Routledge.

Nilsson, F., Olve, N.-G., & Parment, A. (2011). *Controlling for competitiveness: Strategy formulation and implementation through management control*. Malmö/Copenhagen: Liber/Copenhagen Business School Press.

Nilsson, F., & Rapp, B. (2005). *Understanding competitive advantage: The importance of strategic congruence and integrated control*. Heidelberg: Springer.

Nilsson, F., & Stockenstrand, A.-K. (2013). *Accounting and control: The conflict between comparability and uniqueness*. Working paper presented at ENROAC in Jyväskylä, Finland and NFF in Reykjavik, Iceland.

Nilsson, F., & Stockenstrand, A.-K. (2014). Funding, strategies and management control systems: Empirical evidence from two chamber orchestras. In E. Jannesson, F. Nilsson, & B. Rapp (Eds.), *Strategy, control and competitive advantage: Case study evidence* (pp. 213–234). Springer-Verlag Berlin Heidelberg.

Noreen, E. (1987). Eric Noreen on H. Thomas Johnson and Robert S. Kaplan's relevance lost: The rise and fall of management accounting. *Accounting Horizons, 1*, 110–116.

O'Connor, P. A. (2010). Government policy, banks' strategies and the financial crises: Contagion through interconnectedness. *VSE: Vie Sciences Economiques/La revue de l'Economie et de l'Entreprise, 3*, 59–75.

Ocasio, W. (1997). Towards an attention-based view of the firm. *Strategic Management Journal, 18*, 187–206.

Ocasio, W., & Joseph, J. (2008). Rise and fall – or transformation? The evolution of strategic planning at the General Electric company, 1940–2006. *Long Range Planning, 41*, 248–272.

Okamoto, N. (2011). Collective intentionality and aggressive earnings management: Developing Norman Macintosh's arguments in the debate over principles- versus rules-based accounting standards. *Critical Perspectives on Accounting, 22*, 236–242.

Olante, M. E. (2013). Overpaid acquisitions and goodwill impairment losses – evidence from the US. *Advances in Accounting, incorporating Advances in International Accounting, 29*, 243–254.

Oliver, C. (1991). Strategic responses to institutional processes. *Academy of Management Review, 16*, 145–179.

Olve, N.-G. (2014). Success through consistent strategy: How does Scania's management control matter? In E. Jannesson, F. Nilsson, & B. Rapp (Eds.), *Strategy, control and competitive advantage: Case study evidence* (pp. 85–105). Springer-Verlag Berlin Heidelberg.

Olve, N.-G., Petri, C.-J., Roy, J., & Roy, S. (2003). *Making scorecards actionable: Balancing strategy and control*. Chichester: Wiley.

Olve, N.-G., Roy, J., & Wetter, M. (1997). *Performance drivers: A practical guide to using the balanced scorecard*. Chichester: Wiley.

Ong, A. (2003). Fudged accounting theory: Evidence from the UK. *Journal of Management Research, 3*, 23–30.

Otley, D. T. (1980). The contingency theory of management accounting: Achievement and prognosis. *Accounting, Organizations and Society, 5*, 413–428.

Paul, J. W., & Largay, J. A., III. (2005). Does the "management approach" contribute to segment reporting transparency? *Business Horizons, 48*, 303–310.

Peters, T. J., & Waterman, R. H. (1982). *In search of excellence*. New York: The Free Press.

Porter, M. E. (1980). *Competitive strategy: Techniques for analyzing industries and competitors*. New York: The Free Press.

Porter, M. E. (1985). *Competitive advantage: Creating and sustaining superior performance*. New York: The Free Press.

Porter, M. E. (1996). *On competition*. Boston: Harvard Business School Press.

Pozen, R. C. (2009). Is it fair to blame fair value accounting for the financial crisis? *Harvard Business Review, 87*, 84–92.

Rappaport, A. (1998). *Creating shareholder value: A guide for managers and investors*. New York: The Free Press.

Raynor, M. E., Ahmed, M., & Henderson, A. D. (2009). Are "great" companies just lucky? *Harvard Business Review, 87*, 18–19.

Risberg, A. (2013). The stake of high failure rates in mergers and acquisitions. In H. Anderson, V. Havila, & F. Nilsson (Eds.), *Mergers and acquisitions: The critical role of stakeholders* (pp. 247–266). New York: Routledge.

Roberts, A. (1995). The very idea of classification in international accounting. *Accounting, Organizations and Society, 20*, 639–664.

Roberts, J. (1990). Strategy and accounting in a U.K. conglomerate. *Accounting Organizations and Society, 15*, 107–126.

Roberts, J. (1991). The possibilities of accountability. *Accounting, Organizations and Society, 16*, 355–368.

Roberts, J. (2009). No one is perfect: The limits of transparency and an ethic for 'intelligent' accountability. *Accounting, Organizations and Society, 34*, 957–970.

Roberts, J., & Scapens, R. (1985). Accounting systems and systems of accountability – understanding accounting practices in their organizational contexts. *Accounting, Organizations and Society, 10*, 443–456.

Rodrigues, L.L., & Craig, R. (2007). Assessing international accounting harmonization using Hegelian dialectic, isomorphism and Foucault. *Critical Perspectives on Accounting, 18*, 739–757.

Rom, A., & Rohde, C. (2007). Management accounting and integrated information systems: A literature review. *International Journal of Accounting Information Systems, 8*, 40–68.

Ryan, S. G. (2008). *Fair value accounting: Understanding the issues raised by the credit crunch*. Paper commissioned by the Council of Institutional Investors.

Scapens, R. W. (2006). Understanding management accounting practices: A personal journey. *The British Accounting Review, 38*, 1–30.

Schaltegger, S., & Wagner, M. (2006). Integrative management of sustainability performance, measurement and reporting. *International Journal of Accounting, Auditing and Performance Evaluation, 3*, 1–19.

Schipper, K. (2005). The introduction of international accounting standards in Europe: Implications for international convergence. *European Accounting Review, 14*, 101–126.

Scott, R. S. (2008). (cited in Brandau et al. 2013) Approaching adulthood: The maturing of institutional theory. *Theory and Society, 37*, 427–442.

Scott, W. R. (2009). *Financial accounting theory* (5th ed.). Toronto: Pearson Prentice Hall.

Shank, J. K., & Govindarajan, V. (1993). *Strategic cost management: The new tool for competitive advantage*. New York: The Free Press.

Simons, R. (1995). *Levers of control: How managers use innovative control systems to drive strategic renewal*. Boston: Harvard Business School Press.

Skinner, D. J. (2008). The rise of deferred tax assets in Japan: The role of deferred tax accounting in the Japanese banking crisis. *Journal of Accounting and Economics, 46*, 218–239.

Socea, A.-D. (2012). Managerial decision-making and financial accounting information. *Procedia: Social and Behavioral Sciences, 58*, 47–55.

Starr, P. (1992). Social categories and claims in the liberal state. *Social Research, 59*, 263–295.

Stewart, G. B. (1999). *The quest for value: A guide for senior managers*. New York: Harper Business.

Stockenstrand, A.-K. (2014a). Accountability dilemmas and identity struggles. *Working paper*.

Stockenstrand, A.-K. (2014b). *Financial reporting issues and their connection to strategy and management control aspects in Swedish banks 1998–2012*. Working paper presented at a workshop on effects of external demands in the banking sector hosted by Fredrik Nilsson and Anna-Karin Stockenstrand, 11–12 February, 2014, Uppsala, Sweden.

Stockenstrand, A.-K., & Ander, O. (2014). Arts funding and its effects on strategy, management and learning. *International Journal of Arts Management, 17*, 43–53.

Stockenstrand, A.-K., & Nilsson, F. (2013). *Learning by lobbying: The role of networks in bank's interpretation and implementation of accounting standards*. Working paper presented at the Symposium Extending the Business Network Approach in Uppsala, Sweden.

Street, D. L., & Nichols, N. B. (2002). LOB and geographic segment disclosures: An analysis of the impact of IAS 14 revised. *Journal of International Accounting, Auditing and Taxation, 11*, 91–113.

Taipaleenmäki, J., & Ikäheimo, S. (2013). On the convergence of management accounting and financial accounting – the role of information technology in accounting change. *International Journal of Accounting Information Systems, 14*, 321–328.

Teittinen, H., Pellinen, J., & Järvenpää, M. (2013). ERP in action – challenges and benefits for management control in SME context. *International Journal of Accounting Information Systems, 14*, 278–296.

Thompson, J. D. (1967). *Organizations in action*. New York: McGraw-Hill.

Tucker, B. P., & Parker, L. D. (2013). Out of control? Strategy in the NFP sector: the implications for management control. *Accounting, Auditing & Accountability Journal, 26*, 234–266.

Törnqvist, U. (1999). An empirical study of accountability: Delegation of responsibility and external disclosure in some Swedish companies. *The European Accounting Review, 8*, 139–156.

Uniformity in Financial Accounting. (1965). (cited in Zeff 2007) *Law and Contemporary Problems, 30*.

Volberda, H. W., van der Weerdt, N., Verwaal, E., Stienstra, M., & Verdu, A. J. (2012). Contingency fit, institutional fit, and firm performance: A metafit approach to organization-environment relationships. *Organization Science, 23*, 1040–1054.

Wahlström, G. (2009). Risk management versus operational action: Basel II in a Swedish context. *Management Accounting Research, 20*, 53–68.

Wallander, J. (1999). Budgeting – an unnecessary evil. *Scandinavian Journal of Management, 15*, 405–421.

Weißenberger, B. E., & Angelkort, H. (2011). Integration of financial and management accounting systems: The mediating influence of a consistent financial language on controllership effectiveness. *Management Accounting Research, 22*, 160–180.

White, L., Clinton, B. D., van der Merwe, A., Cokins, G., Thomas, C., Templin, K., & Huntzinger, J. (2011). Why we need a conceptual framework for managerial costing. *Strategic Finance, 93*, 37–42.

Young, J. J. (2006). Making up users. *Accounting, Organizations and Society, 31*, 579–600.

Zeff, S. A. (2007). Some obstacles to global financial reporting comparability and convergence at a high level of quality. *The British Accounting Review, 39*, 290–302.

Zeff, S. A. (2008). The contribution of the Harvard Business School to management control, 1908–1980. *Journal of Management Accounting Research, 20*, 175–208.

Östman, L. (2009). *Towards a general theory of financial control for organisations*. Stockholm: EFI.