

Lars Östman

The Need for a Different Approach to Financial Reporting and Standard-setting

Abstract

International Financial Reporting Standards are questioned. Possibly, there is a need for a different kind of standards and a different procedure for developing them. No doubt, there is a need for a more profound theoretical approach to these issues. Theory-building in accounting should include approaches whereby problem descriptions have a broad coverage and cross the borders of traditional specialisations. In this paper, a theoretical approach is outlined. According to this approach, insights into control problems for every organisation and system can be gained by analysing relationships between global value chains and a hierarchy of one or several organisations. Time is crucial. Instrumentality is regarded as an inevitable and necessary guide line for any control system that relates resources to functions and visions. Instrumentality concerns the effects of tools on certain functions. In the paper financial reporting and standard-setting are placed in a wide context in which longitudinal relationships are essential for individuals, organisations and control systems. Historical trends are observed. Basic financial accounting concepts and their relationships with business events are discussed. The importance of uncertainty for financial reporting is emphasized, and so is the fact, that control from top-levels is exercised at a distance. A tendency to instrumentalism is also recognized: measures and processes, for example standard setting procedures, tend to be important in themselves, irrespective of ultimate economic functions in a wider perspective. The analysis in the paper of financial reporting and standard setting is one application of a general approach to financial control for all types of organisations. The general approach is based on a number of previous research-oriented books published over several decades and the author's specific own experiences from internal and external processes with organisations in focus. Consistency and integrative power of the ideas have been tested in relation to certain books in various fields outside the core of the subject: applied systems theory, theatre, sociology, economic history, institutional theory and economics.

Key words: financial reporting; International Financial Reporting Standards; standard-setting; accounting standard setting bodies; supervisory boards; corporate governance; transparency; market value accounting; mark-to-market; fair values; historical values.

SSE/EFI Working Paper Series in Business Administration
No 2010:1
January 2010

CONTENTS

BASIC IDEAS	1
Purposes	1
The theoretical approach	2
Describing the design of control systems	3
A PERSPECTIVE ON ECONOMY AND ORGANISATIONS FROM THE POINT OF VIEW OF INDIVIDUALS	4
AN ORGANISATIONAL PERSPECTIVE – COMMON AND CONFLICTING INTERESTS	5
Horizontal structure and a separate organisation.....	5
Vertical structure and other influencing interests.....	6
Principal relationships between vertical line and horizontal line	7
Uncertainty, observability and mobility	7
Changing patterns.....	8
HOW FUNCTIONS AND VISIONS ARE RELATED TO RESOURCES – FINANCIAL CONTROL SYSTEMS	9
Inherent aims of financial control systems for organisations	9
Distance and influence of control subjects	10
Needs, demands and potentials	11
Being attractive and convincing - a necessity for a separate organisation	11
Financial accounting concepts.....	12
International reporting standards.....	13
Connections between external and internal processes.....	14
Organised examiners and supervisory boards	15
Comparability.....	17
A tendency towards instrumentalism	18
SPECIFIC HANDLING PROCESSES AND TIME	19
Long-term development of structure and control systems	19
Ex-ante stage, conduct and reporting	20
Effects of organisational handling.....	21
PRESENT FUNCTIONS AND TRANSFORMATION – VIEWS ON FINANCIAL REPORTING SYSTEMS AND STANDARD-SETTING.....	21
Functions and instruments.....	21
Functions and financial control for organisations	22
Control subjects and objects.....	23
Control of controlling organisations.....	24

Research	25
REFERENCES.....	26

BASIC IDEAS

Purposes

Many fields of the social sciences have their special approach to control problems and are, in this sense, intentionally fragmented. As a matter of fact, limitations and focuses within defined boundaries are often regarded as research virtues. Specialisation has increased. With a systems-theory view on real-world problems, it seems quite obvious that each field represents both deep insight and “disciplinary hubris”.¹

Also, various accounting-related fields are partial fragments. Basically, financial accounting is one subject and management accounting and control is another. Managing and controlling market-based companies is studied as one issue, public administration is regarded as something else. Most research studies are restricted to a very limited problem. Partly as an effect of this, there is a tendency to describe governance instruments and processes separately without relating them materially to the world they affect.² Researchers argue for certain specific concepts and objectives within a theoretical framework and let other considerations stay outside the theory and become part of the use. This is a well-known phenomenon that has become more and more important over the years.³

Often some important views are imbedded in the very limitations of a practical issue or research design. Furthermore, only certain aspects are considered – I call this partitioning. The wider the perspective, the more difficult it is to reach a firm conclusion about the design of control systems or the interpretation of a control problem. The fundamental problems have been discussed at least since Plato and Aristotle, without any remarkable success.

Thus, theory-building should include approaches whereby problem descriptions have a broader coverage and cross the borders of traditional specialisations. This is true of control-oriented social sciences in general, and the fields of financial reporting and standard-setting are no exceptions.

I intend to outline a theoretical approach of financial reporting and standard-setting with the above as a background. Accounting and control tools, including financial reports, need to be discussed as devices that have many effects, observable or not, in broad and not well-defined contexts that comprise multiple areas of significance. My ground is a number of previous research-oriented books published over several decades – mostly in Swedish⁴ – and my own specific experiences of internal and external processes with organisations in focus

¹ The term is quoted from Holding, C.S., Gunderson Lance H. & Ludwig, Donald, *In Quest of a Theory of Adaptive Change*, chapter 1 in *Panarchy. Understanding Transformations in Human and Natural Systems*.

² See, for example, Scapens, Robert W. & Bromwich, Michael, *Management Accounting Research: the first decade*, Shields, Michael D., *Research in Management Accounting by North Americans in the 1990s*, and Beattie, Vivien, *Moving the financial accounting research front forward: the UK contribution*.

³ See, for example, Watts, Ross L & Zimmerman, Jerold L., *Positive Accounting Theory*, chapter 1, for a general discussion in the 1980s about this phenomenon. Nevertheless, research conclusions may be far-reaching despite narrow frameworks. For example, in a research contribution, *Financial Reporting Transparency*, Mary E. Barth and Katherine Schipper define and promote the concept of transparency with only a very limited contextual analysis.

⁴ Two works in English are Johansson, Sven-Erik & Östman, Lars, *Accounting Theory – Integrating Behaviour and Measurement*, 1995, and Östman, Lars, *The long range dynamics of financial control. The Royal Dramatic Theatre and its costs over a century*, 2007.

over the same period.⁵ In addition, I have tested the consistency and integrative power of my ideas in relation to books in various fields outside the core of my subject: theatre, sociology, applied systems theory, economic history, institutional theory and economics.⁶ This paper is based on one recent book by me, in which I discuss financial control in general terms.⁷

The theoretical approach

My general approach of financial control can be described in simple terms as follows. There are global value chains, from resources to output that are in use. These chains change with time. Uncertainty and unpredictability prevail for the present state and for possible changes; to some extent it is possible to estimate risks of the future. At any moment, each organisation has taken some limited position on a chain. Each organisation has a hierarchy which lies above operations. Over time, chains, organisations, hierarchies, output and personal functions vary. According to my approach, insights into control problems for every organisation and system can be gained by analysing relationships between global value chains and a hierarchy of one or several organisations. Time is crucial.

Described in more elaborate terms, this theory consists of a description of an extensive course of states and events where no time-limits are imposed. At each point in time, many types of relationships exist with at least some connection to the organisation. What the description of all these relationships covers is the **latitudinal** dimension. In principle, there are no spatial limits to my description but I concentrate on the situation in a Western country like Sweden. There is also a **longitudinal** dimension – this description involves the passage of time.⁸ In principle, there is no obvious beginning. For practical purposes I have used The second Industrial Revolution as a starting point. With my references to Swedish experiences that means the last few decades of the 19th century.

Four latitudinal areas are defined: economy and organisations from the point of view of individuals; an organisational and structural perspective; the financial control systems; specific handling processes of organisations for certain issues. They partly overlap, but they represent strikingly different points of view. They are described below. Each latitudinal area

⁵ Some main concepts and ideas of this text are clearly connected to my experiences of practical problem-solving in actual cases. A set of systems criteria that are described below was developed when I was confronted with a complicated management control design decision in a metal-work company in the mid-1970s. Around 1990, I used the concepts of vertical and horizontal control processes in order to understand control mechanisms in an energy company. In this text, they express the basic structure. Many years later, I analysed the changed conditions of a traditional insurance company. I developed ideas that are described below about the relationship between profit-oriented and non-profit organisations.

⁶ The most influential sources are Hayman, Ronald, *How to read a play*, ideas in linguistics and semiotics, Gunderson Lance H. & Holding, C.S., eds., *Panarchy. Understanding Transformations in Human and Natural Systems*, Habermas, Jürgen, *The theory of communicative action*, Ferguson, Niall, *The Ascent of Money: A Financial History of the World* and Baumol, William J. & Bowen, William G., *Performing arts – the economic dilemma: a study of problems common to theatre, opera, music and dance*.

⁷ Östman, Lars, *Towards a General Theory of Financial Control for Organisations*, also available in digital form.

⁸ I have explored an idea in Hayman, *How to read a play*. He writes, page 50: “In a novel or a play... there are two basic kinds of relationships. The *latitudinal* relationships are those that exist simultaneously at any one moment of action, while the relationships involving the passage of time are *longitudinal*.”

has its course and its own relationships with time. Time patterns differ between areas. Courses of different latitudinal areas may be sequential, occur simultaneously or be interdependent. They comprise relationships within global value chains, hierarchy processes and interactions between the two. I call value chain processes horizontal processes. For each organisation, with its part of the total horizontal chains, there is a hierarchy and a structure above operative units. Bodies of the formally highest order and all other of these units are linked together by a process, including certain procedures for decisions about the organisation and its parts. I call this a vertical process.

The pattern of transactions and relations between parties is in itself an important component of the total control system. Beyond this, particular control systems are explicitly introduced, for instance, systems of financial reporting and management control. These systems are developed in response to an existing structure, but often they will also reinforce the properties and tendencies of this structure. Prevailing structures and control systems constitute a decisive basis on the occasions when an organisation goes through specific processes regarding certain issues.

Companies are strong driving forces in society. Financial impulses from the outside and internal methods to maintain economic control are decisive for their actions. I have an instrumental view of organisations and of the constructions of financial control tools for organisations in a society. Instrumentality concerns the effects of tools on certain functions. Ultimately, the personal functions of human beings, present and future, constitute the fundamental reference point in a theory of financial control. As a key intermediate step, existing and possible functions of financial tools for organisations are most essential. Control devices should be discussed with regard to inner characteristics but also possible effects. From a financial control point of view, identifying relationships between activities and financial processes is a general and basic issue. How are the financial limits for activities set? What are the consequences?

I regard instrumentality as an inevitable and necessary guide line for any control system that relates resources to functions and visions. Thus, philosophically I have a pragmatic view of this issue. However, economic systems and the “lifeworld” of individuals cannot really be separated.⁹ What happens in economic systems provides not only material conditions for people’s lives but also has many deep repercussions in social and other dimensions in “lifeworlds” that have another rationality. Time is a main aspect.

Describing the design of control systems

Financial control systems are defined as mechanisms that relate visions and functions to resources and where money is involved directly or indirectly. Ultimately, they are based on money, that is to say, widely transferable rights and obligations that presume trust in transferability and, as media of exchange, make almost all sorts of transactions possible.

⁹ The concept of Instrumentality is widely discussed by sociologists and philosophers. Jürgen Habermas uses the concept and also the concept of “lifeworld”. Technical, economical and political systems are governed by instrumental reasoning and represent something different than “lifeworld” of individuals. However, what happens in these systems strongly affects the “lifeworld” that basically has another rationality (for example, Habermas, 1987, chapter. VIII). Within auditing and accounting, Michael Power talks about “colonization”, when economic perspectives and rituals for verification take over.

Control systems, with money as the fundamental element, have a broad and varied character. My descriptions of such systems cover some different and interrelated primary aspects.

How are rules related to each other? Applied rules – about decision-making, measurement, financial sources, payments, construction of financial instruments, procedures and communication – can either be legal by nature or simply be exercised practically. The issue of how rules are related to each other is important not least in the fields of financial reporting and valuation. Consistency is decisive for what the meaning of various comparisons will be.

What is represented and how is this done? The contents of financial control systems can be regarded in relation to individual events that will take place or have taken place. Numbers and text are common tools of expression but not the only ones; for instance, visual means have become more and more important, even if it is difficult to show an administrative process visually. For financial reporting and for valuation representation is an important aspect.

Who are the intended or actual users of a system, in what context do they use it and how do they use it? A users' perspective can be applied to a financial control system. At least since the mid-20th century, usefulness has been a keyword in academic texts about financial accounting as well as management control. When particular systems are designed, developers normally think of a target group and representation is varied with regard to usefulness and the behaviour of this group. Designers have acquired some picture of this behaviour in the specific case – they accept and adapt to it or they want actively to change it (which is common for internal systems).

A PERSPECTIVE ON ECONOMY AND ORGANISATIONS FROM THE POINT OF VIEW OF INDIVIDUALS

The first latitudinal area concerns the functions for human beings of what is accomplished through organisations, their activities and output – functions of a personal, family and collective character are satisfied, including very vague and/or very individual functions.

After industrial evolution and constitutional reforms in the mid-19th century, financial and political systems began to develop. Gradually, new prerequisites for economic activities led to material progress for many people and also modified functions generally. Output from organisations made it possible to improve material functions: goods and services with specific properties could be utilized as means for personal functions in a direct and general way, irrespective of differences in social and personal context. Not least primary needs could be satisfied. Beyond material functions, there were also experiential functions of output that were closely related to social and personal contexts. Dependencies within a family diminished and were replaced by other dependencies. An adequate financial function was needed to afford improvements of material and experiential functions: the capacity to provide financial resources and ways of handling such resources.

Within rather short periods in the late 19th and early 20th centuries, many industrial organisations were established or restructured, providing products and work. Financial institutions developed too, basically to handle money and risks: individuals could turn to banks and insurance companies that had often specialised in satisfying a limited function or a geographical area. Stock market trading acquired more systematic forms. A personal financial function was needed by every household as a decisive prerequisite. States and other public bodies developed. According to parliamentary democracy, each adult citizen had the vote, nationally and locally. States created systems for certain material functions and the

transmittance of money. Different sides of economic activities, such as work, consumption and saving, were no longer so firmly interconnected within a family or even for an individual. Each employed individual had a working relation with one organisation and each family used output from many.

Towards the end of the 20th century, the transformation of economic activities had developed a rather global nature. In a way, this could be seen as one further step in a process that had already started with national transformation before or at the beginning of the century. Far-reaching global structures for financial and non-financial organisations had evolved to handle the various sides of economic and financial activities. Immediate material functions had been improving in many parts of the world but primary functions were quite unsatisfactory in other parts. Improvements and uncertainties had a global context; they were both shared within larger systems than before. Interconnections mean that benefits and burdens of uncertainties are shared by many people and units and they also mean mutual and common dependency. Larger, complicated structures decrease adaptive capability. In a country like Sweden, there were improvements and flexibility for many people but also personal vulnerability with regard to financial functions. Towards the end of the century, public administration within national boundaries had its own structurally growing problems. Uncertainties made the long-term sustainability of environmental functions genuinely unpredictable.

AN ORGANISATIONAL PERSPECTIVE – COMMON AND CONFLICTING INTERESTS

The second latitudinal area concerns the structure of organisations and activities and of transactions and relations that various parties have with each other. Structural forces operate in and around an organisation tacitly or obviously, slowly or rapidly. Much of this can be identified only by considering the structure thoroughly.

Horizontal structure and a separate organisation

At one end of the activity flow of an organisation there are resource providers and at the other end there are users of output. *Resource providers* are individuals or other organisations. Not least those who are involved personally in the organisation, *workers*, constitute a key group. They have reasons for holding two parallel perspectives, one as a participant among others in organisational processes and the other as an external provider who has his/her own context: what does this give me? *Suppliers* may develop long-term relations to an organisation, beyond conventional competition in a market. *Lenders* have, in principle, a contractual right to compensation, not a residual right. *Users* are other organisations or individuals, end users. A company meets either professional buyers and users or individual human beings who are trying to satisfy material and/or experiential functions. An acceptable price – an exchange value – is potentially important for buyers and mostly also for users. Use can be long-range or temporary, urgent or dispensable.

Borders to the surroundings of organisations are not sharp. In part, activities, functions and dysfunctions in the horizontal line do not recognize any organisational borders, and besides, they may change gradually. An end user may have a very distinct interface with a selling organisation, as is the case when s/he uses a physical product on her/his own. Or the interface is more diffuse; people of the providing organisation interact with the beneficiary.

Each party has its own position against an organisation as such, including those who work there.

Despite a lack of absolute horizontal borders, most organisations, to some extent, tend to live in separate worlds. They focus on their own activities, interpreted and represented at each point of time by an inner circle or a leader. Operations are developed according to external impulses, internal mechanisms, previous experiences and views about the future. Organisations stand for continuity. They embody knowledge and identity, and they may function as centers of experience and attention. In those cases, established values will have a self-evident weight and will affect what is being done. Sometimes, individual affiliation may even induce a feeling of deep fellowship, though perhaps only temporarily during employment.

Vertical structure and other influencing interests

Western economies that developed during the 19th and 20th centuries required an infrastructure of functions and organisations, not least civil laws about ownership. *General rule-makers* are public or private organisations that institute laws, prescribe standards or publish recommendations for society, including activities run by organisations and capital issues. *Organised examiners*, for example auditors, conduct regular reviews in individual organisations mainly on behalf of principals in the vertical line. *Supervisory boards* are public or private organisations that are in charge of general supervision. They have the option of taking measures when some organisation does not comply with general rules. *Operative authorities* deal with law issues of another type than general supervision, for example taxation or permissions for mergers and acquisitions. *Representatives* act on behalf of somebody who is directly affected by activities in an organisation.

Within an organisation, there are *operative units* and a hierarchy above them. *Central executives* cover the entire organisation. Activities directly under central executives are divided according to one main criterion, or a combination of several. In turn, each subunit is divided into smaller subunits on several levels. Total activities may contain a great number of dimensions that may be reflected in organisational patterns and procedures; in large organisations, complexity is unavoidable. Often, there is a *board* above central executives. Accumulated capital is available in the vertical line. *Financial principals* are at the top of the hierarchy; sometimes they appear step by step.

Some actors are important in diagonal processes, that is, they do not have their own horizontal or vertical identity but they can share perspectives in their way of handling matters. *Professional observers* view an organisation at a distance. They have roles defined by parties that are total outsiders in relation to the organisation, general rule-makers and supervisors. Here, I am thinking of analysts, journalists and academics who teach and write, for example.

In many respects, interests are common for the various parties around and in an organisation. By fulfilling a function for one party, an interest for another party is also satisfied. Even a feeling of affinity may arise. In a fundamental sense, though, ambitions are often in conflict. Each individual tends to base his/her actions in a certain context on his/her own separate interests, or separate interests close to him or her. However, linking also takes place from various points of view – people try to connect different perspectives or processes. To a high degree, global economic structures have been shaped in a dynamic process of quite separate interests.

Principal relationships between vertical line and horizontal line

Companies are pay-driven organisations, not function-driven. Principals of the vertical chain may satisfy their interests through payments from horizontal activities, their ultimate aim is not to satisfy a certain function for particular beneficiaries and they are willing to consider various options in terms of activities and output. In pure cases, there is no coupling between principals of the vertical chain and beneficiaries to utilize the specific horizontal process, beyond the transfer of money. This does not mean that material, experiential and operational functions are unimportant, but specific functions for specific groups are not the ultimate and primary concerns. Basically, vertical principals of pay-driven organisations are in the business for the sake of surpluses, but of course their motives may be related to specific horizontal processes as well. The alternatives of developing or winding up can be evaluated for a unit irrespective of other units. Selection is important, as well as competitiveness.

Every organisation needs a financial function: the capacity to provide activities with financial resources and ways of managing such resources. Pay-driven units are based on the original capital input from founders and the subsequent non-periodical input that may have been determined by special decisions. Often, the most essential source is capital accumulated through retained earnings, period by period. Financial benefit is related to individual input. Normally, individual shares represent transferable values.

For transfer-driven organisations, principals in the vertical line have no direct interest in a specific horizontal process, with the possible exception of markets where transfers and financial transactions are made. Their focus is basically on transfers of equities or parts. The selection of equities is a core activity. In addition, adapting organisations in order to facilitate transfers may be a main interest. Shifts in ownership may take place because transfers are possible and without any particular relation to horizontal structures for the future. Attractive media story-telling becomes blurred with acquisition processes in a narrow sense.

Uncertainty, observability and mobility

Analyses, information and debates about an organisation have two important conditions. The first, uncertainty and risk, is shared by everybody, even central executives.¹⁰ Normally, uncertainty is greater or at least different for external parties; in that sense there is information asymmetry. The second condition is possibilities of observation. What could be noticed about the current situation and output, where could it be observed and how could it be expressed? Some circumstances are easily captured, some get major exposure and still others can be conceived only close-up. Measurability varies. Quality differences, in a non-subjective form, can be attached only to some output, and in certain respects.

Principals at the top have a special mobility because they have alternative uses of money. Financiers are in a position to direct requirements placed on the activity, explicitly or

¹⁰ Often distinctions are made between risk, uncertainty and genuine uncertainty. I use the term “uncertainty” as a general expression for various kinds of unknown or unpredictable states, irrespective of what type of variable is concerned. When I make a distinction, “risk” refers to a future state where something specific may occur; sometimes probabilities are attached or can be attached to this.

implicitly, in combination with financial frameworks that are more or less clear. Each activity that needs money from the outside must be sufficiently attractive in these respects and for the users of output. Functions and visions of an organisation with a continuous activity are confronted with a need for financial resources for alternative use. Divergence between the two perspectives is intrinsically unavoidable. Decoupling between activities and the financial function can only be temporary – although it may be difficult to predict acute points of time.

Changing patterns

Value chains change over time, as do hierarchies above horizontal flows, diagonal forces and the role and functioning of particular organisations and sub-units: how dependencies and independencies are constructed, operationally and financially, and what conditions there are for the financial function of organisations. In this course of events, structure influences financial control systems, which in turn are important for how structure can be designed and work. Analytically, structure and financial control systems can be separated, but they are two interwoven elements of financial control. Structure and financial control systems vary between countries and over time, even though most similar long-range phenomena sooner or later appear in different countries.

At an early stage, pay-driven companies were managed by an owner and a family and the circles around them, on their conditions. People in the neighbourhood were dependent on their attitudes and financial capacity. Most sub-units within the pay-driven organisations concerned functions. During the 20th century, vertical structures and processes developed fundamentally. They were strengthened, both outside and within organisations. Power distribution along the vertical line varied, but generally there was a clear trend towards conditioned decentralisation. Shorter time periods were followed up more frequently. Not only wealthy individuals but also people in general became dependent on rates of return on stock markets as a financial source. This change, implemented through institutional ownership, affected how the economy worked. Also, the vertical structure became more and more multinational for private organisations. In certain cases, owners came from various countries, group management and headquarter from another country than most of the owners, subsidiaries were located in a third and operating units in a fourth country, which might be the same as for some of the higher levels. For nations, not least in Europe, super-national levels developed in critical respects.

In the horizontal line, structures and financial control systems were more and more oriented towards specific use, immediate use, target groups or at least pronounced views of target groups. The period in and around the 1970s was an exception to this development, with a heavy emphasis on union and employee perspectives. At the same time as the focus on tangible use gradually increased, the activities of many units had more distant connections to end use. To an increasing extent, horizontal flows were extended across national borders. Thus, interdependences were more complex, including being more comprehensive spatially. Technology and the internet changed patterns and distances between organisations and users. Efficient relations with an output user from an organisation's point of view did not necessarily mean routines that favoured pre-use contacts, accessibility and contacts at the moments of use from the users' point of view. Often, experiential functions of output required flexible human use contacts rather than the technical properties of a computerized communication system.

HOW FUNCTIONS AND VISIONS ARE RELATED TO RESOURCES – FINANCIAL CONTROL SYSTEMS

The third latitudinal area covers the control systems in the sense of recurring procedures and methods that are used to relate present and future functions to resources, externally and internally. These financial control tools are important from an individual organisation's point of view but also for larger economic systems. A good many recurring procedures and methods can rather easily be perceived on a current occasion and also be described afterwards. A theory of financial control for organisations places a natural emphasis on them, and they should be viewed in the context of the three other latitudinal areas.

Inherent aims of financial control systems for organisations

The interplay between an organisation and its surrounding parties is important for internal systems. External impulses and internal control procedures, interdependently, shape systems and patterns that are vital for the ways in which functions and visions are related to resources at the organisational level as well as at higher levels. They are instruments for dimensioning, for activity orientation and for efficiency. They emerge over time – evolutionarily step by step and through particular systems design decisions.

At early stages during the 19th century, accounting and costing systems almost only covered actual events in specific cases, and very little besides that. Extensive, integrated organisations that were financially coherent and basically centralistic were typical of the state and ambitions of business life at the beginning of the 20th century. Only a few fictional and future-oriented complements were introduced. Stimulating the survival of existing companies was an important purpose of accounting and costing. Connections between companies and individuals were durable and strong. Risk at company level was the focus of systems. Financial power and mobility at this level were major aspects.

Gradually, intentions shifted towards other perspectives, such as the possibility for financial principals to evaluate and government taxation. Thus, similarity and comparability became central aspects. Internally, the idea of opportunity costs was also applied to business problems but it never became essential for product-costing on a regular basis. In addition, discounting techniques for special judgements were introduced.

In the middle of the century, the group concept got a foothold, both in management control and financial reporting. The idea of governing groups and of reporting their income continuously to the public had then been established, not only in the USA. To some extent, such permanent organisations became centres of knowledge, experiences and identity. The survival of these groups was an important aim, even if owner perspectives were strengthened. The risks not to survive, financial power and mobility at group level were main considerations. Views on company financial structures and public financial reporting expressed this idea, but gradually, shareholder interests were given more and more weight. Still, accounting and costing systems for continuous control emphasized actual events in specific cases, but purely economic and future-oriented concepts became a more essential ingredient. At the mid-20th century, circumstantial and ceremonious procedures for long-range planning and budgeting were introduced. Pseudo-commercial techniques were used for operations, but not for financial allocation.

Towards the end of the century, organisational development broke up from these ideas, partly as a result of financial realities and considerations. Market procedures served as a

model for pseudo-commercial techniques even for financial functions. Financial concerns at upper levels became more urgent. Vertical structures had an important shift. Decision power moved one or two steps upwards, away from direct representatives of organisations that were close to material functions and experiential functions outside the finance field. Time periods that were followed up became shorter and regular monitoring became more frequent.

At this time, planning and budgeting rituals were simplified in many ways. However, this did not mean that the ex-ante stage became less important. On the contrary, presentations about the future, expectations and visions gained some predominance, at the expense of descriptions of the past. Expectations and demands at upper levels were prevalent. These were pivotal in follow-up procedures, often attracting great attention in mass-media reporting. In financial markets, ideas of opportunity costs and discounting were applied on a regular, frequent basis. The financial function of an organisation was not the major concern, rather an optimal trade-off between risk and return on securities.

Distance and influence of control subjects

In many cases, large groups of individuals are the ultimate vertical power – either as owners of shares in a corporation or as participants in collective saving. They are not organized and they are at a considerable distance from significant activities. Special organisations are founded to handle the interests of individuals in such cases. Thoroughly penetrated and common goals are difficult to find. As a result, the executives as well as individuals concerned have room for the interpretation of collective meaning. Each individual may express views about each limited side of the economic issue, irrespective of what other views s/he may have about this issue in other contexts.

In addition, savings institutions may be a last vertical power in cases where they have an ordinary horizontal position as supplier in relation to investors and savers as customers. Several steps are possible. Savings institutions are in turn customers of other organisations. For example, an institutional investor buys shares in private-equity-funds and may proceed with the same type of requirements as every big customer in the financial field. Events at the highest levels of the vertical structure take place in horizontal processes concerning financial organisations. Conditions are shaped in this way for organisations that are closer to many material functions and experiential functions.

Thus, organisations with allocation as a main role will have funds at their disposal, either through business transactions or transmittances that are determined. Such units act at a distance from their ultimate principals or their customers. At the same time, they act at a distance from many horizontal core processes that, in the end, may be affected. They are themselves exposed to all the general mechanisms of organisations, including the need to appear attractive to other parties. This is true of institutional investors. If not in any other context, ambiguous goals in such organisations will be sharpened into something that is not controversial from a professional point of view, a high return on capital, considering risk and expected inflation. Sometimes, a smooth return is talked of as a realistic aim, no matter what the uncertainties are in underlying activities. Financial goals do not prevent institutional investors from expressing further restrictions on what corporations should do – so called external governance.

Moreover, organised examiners, surveyors and professional observers have a distance to horizontal down-to-earth processes. Analyses at a distance concentrate on visible and measurable evidence that it is possible to communicate. Many units should be dealt with and compared. Analytical tools, especially with quantitative approaches, are appreciated. Some aspects are easier to quantify than others. Interpretations of crude or complicated numbers

have many possible pitfalls. What seems to be an indication of improved productivity may sometimes just as well be a sign of lowered ambitions.

Needs, demands and potentials

In horizontal, vertical and diagonal processes, plans and outcome are compared with two kinds of reference levels: the needs of a unit and the potentials of a unit. Levels of need go back to external interests or the needs for the unit as such. External demands are primary. What needs to be achieved in order to satisfy essential parties, including principals, workers and those who may use output? External parties express demands with various degrees of clarity and power. Levels of potentials imply what it is possible to achieve. For pay-driven organisations, what combinations of product prices, wages and surplus is it possible to reach? Historically and externally based aims are often applied in order to approximate levels of needs and potentials. Thus, rate of return requirements and levels of risk are estimated with regard to what has previously been customary. Benchmarking with values from good examples provides levels of potentials for entire organisations or sub-units.

Some interests and needs, first and foremost, are connected to financial functions and dimensions. Values-in-exchange between independent parties are crucial – for everything. Long periods of shifting price expectations may occur before a transaction is actually accomplished, but value-in-exchange at a particular moment and in a particular case is what counts, after all. For financial instruments, series of payments are the core. Amounts, risks and time are main variables. Financial principals may get a return either continuously or on individual transactions or investments. For them, with many investment opportunities, general price development is a natural reference for evaluating return, rather than prices that are of specific interest for a certain activity. They need concepts that represent general purchasing power and can provide a basis for comparisons for the past and for the future. It is not necessary to define a time perspective, but sometimes a limited period is predetermined, such as three or five years, which for example is true of private equity-firms or hedge funds.

For each company, functions and visions must take place within financial limitations that are determined either by market-driven flows or funds allocated. A lack of liquid assets constitutes the most absolute financial constraint. Legally cogent rules for items on the balance sheet and income statement, such as the rules for liquidation, in reality permit a somewhat greater scope for alternative action. The basis for covering financial needs and risks is normally their own generation of equity capital.

Being attractive and convincing - a necessity for a separate organisation

In a way, relations to users of output are the most basic ones. Organisations, whether pay-driven or function-driven, need to be attractive and need to convince people that they are. During the second half of the 20th century, marketing, market strategies and marketing information systems developed. How do users think, how satisfied are they and to what extent do they have perceptions on what they want? Gradually, considerable efforts have been made to identify the contexts of users and to adapt products, messages and systems to large or fragmented target groups. Products and commodified services have been developed to suit user contexts. Sometimes they are even tailor-made. Rather often, contexts as such are developed and communication with this aim may be as important as products in an original

sense. Actually, for many organisations, marketing efforts of these kinds have no limits except costs. Investments in brands may be regarded in this perspective.

Moreover, the shift upwards in vertical structures has induced a need to argue and convince. Those who supported the idea of so-called corporate governance have been successful, promoting such a development in stock markets. Mass-media processes have become a central governance and control issue. Organisations and their representatives adjust to this phenomenon partly by promoting ideas and concepts publicly, partly by developing defence strategies in case of threatening emergencies. Often, an essential part of both external and internal communication is a matter of convincing a professional observer successfully.

Financial accounting concepts

Accounting measures can be interpreted as signifiers in relation to something signified. Their construction can be seen as symbols in relation to events and states outside the accounting system.¹¹ Furthermore, accounting data have an autonomous legal and contractual role in events as such, for example as formal bases for dividend decisions and taxation. Accounting representation is fairly easy to interpret when book entries directly connect to an individual series of well-defined transactions. However, data may refer to present or future circumstances that are not an actual, specific part of a process for an individual organisation. Then, perception of processes and states and their sequences may serve as a reference point for interpreting amounts and book entries but not necessarily with an unambiguous result.

Naturally, income concepts and value concepts for financial entities are related to market prices and series of payments from a certain unit's point of view. In this context, concepts can be given a meaning irrespective of functions and dysfunctions outside the organisation. Representation of horizontal events is a key accounting issue. Observed values-in-exchange on certain occasions for resources of a specific unit have been a traditional basis. A user perspective on resources has been dominant; resources have been acquired to fulfil a function in ongoing and continuous activities. What has already happened is pivotal, but a glance at the future is also made. Maintaining existing capacity may be the aim of evaluation. Predictions of exchange values are made, for instance when accounts receivable are written down. In addition, evaluation may be based on future series of payments that are caused by existing resources. However, tying a value to each specific cooperating resource may be difficult or logically impossible.

As an alternative, "fair values" might be the idea. General market prices and market values outside an organisation can be the starting point of evaluations. Some unit-specific events have not taken place and possibly will not even take place later on. According to such an approach, values-in-exchange are gathered from other contexts than the particular case, and explicit particular aims of a resource are disregarded. A separable part of company resources is evaluated on the perception of how and to what price this resource should be traded if there was a mutual exchange between two parties. Estimated prices are booked.

Exchange perspective approaches are common, not least within the vast financial field. For many instruments of standardised and rather substitutable types, prices are quoted continuously. Managing securities, in a broad sense, and values-in-exchange are the core of business. Basically, securities are separable from each other. In that case, accounting that is

¹¹ The concepts of "signifier" and "signified" refer to ideas from linguistics, used later on in other academic fields, such as analyses of theatre plays. Within accounting, Ijiri uses a similar pair of concepts in *The Foundations of Accounting Measurement*, principals and surrogates.

based on currently possible exchange values gives a fairly good representation, in contrast to those situations when instruments are not very liquid. Then values-in-exchange exist but less frequently. Or traded instruments are less standardised. This means that a singular quoted price is more difficult to interpret as a representation in accounting. In certain cases, market prices do not exist. In those cases, instruments are evaluated by models that require assumptions about future-oriented variables, such as expected earnings, expected cash flow or volatility. Thus, there is no real state to signify at all. Measures are pure constructions based on some more or less well-defined premises.

Relationships between income concepts and horizontal events are especially problematic when resources are valued on market conditions despite the fact that they are included in a certain functional context with certain intentions. Resources have been acquired, not to be disposed of but to be combined with other resources in order to produce products that will give ongoing revenues. This way of combining resources should give something more than all the resources separately. Market evaluation is governed by the notion that separable parts would command a certain price if market relations were prevailing. Thus, evaluation is made irrespective of the particular context and intentions and of the special dependencies for resources that are distinctive features of a case. Market prices of separable parts do not mean a good representation of an ongoing process where specific transformation is in focus. Rather, it represents value development for resources in their general context. Specific processes of activities, input and output are not basically supported.

Thus, accounting based on market prices presumes hypothetical perceptions in the representation of a company involved. Some separable part of company resources could be traded between independent parties. Often no exchange takes place. Pricing conditions that are not specifically tied to the company in question may be observed for many types of relations in more or less well-defined markets. For separate resources, a price is established for each transaction and occasion with impulses from many different contexts. Market-price accounting pinpoints separate resources and prices that are quoted at each point of time, rather than combination and transformation as such. Thus, a change perspective is an underlying factor and alternatives to current use are important. In extension, resources could be included in other contexts, contributing to various new alternatives. Ultimately, resources have many possibilities and interdependencies, and there is an endless number of gradual alternatives, though basically no alternative exists at the global level from a biological and physical point of view.

Often public income measures are a mix of components. Towards the end of the 20th century, values-in-exchange from specific events tended to be less dominant than before – more often, evaluations were based on market prices and models. One part of the background was standard-setters' ideas of information usefulness. They seemed to perceive that such values served equity analyses, or should do. In turn, volumes of analyses had increased previously, due to the fact that trading with shares and companies had become an autonomous activity in business life. A change perspective on business structures and values-in-exchange had become an important element of vertical processes. Public accounting during the last decade of the 20th century captured these tendencies and promoted them. Thus, the use of resources perspective was no longer a dominant principle to the same extent as before in financial accounting.

International reporting standards

International reporting standards have undoubtedly become very complicated from a technical point of view. They require expert knowledge far from traditional, important

business competence of different kinds. Thus, a huge market for consultancy has evolved. Reporting tends to be an issue for reporting specialists, not for responsible managers and boards.

For many years international standards were relatively vague. They expressed some kind of acceptable lowest common denominator for the countries involved but each national standard was predominant. These conditions changed, however. International standards became more detailed and were to an essential extent implemented in national and super-national jurisdictions. The infrastructure of standard setting was strengthened and standards began to have more important legal and contractual functions. At the same, the role of financial reporting in societies was developed and to some extent clarified. There are good reasons for looking at financial reporting standards in a much wider context than the professional area of accountants, auditors, standard-setters and supervisory boards. Critical moments arise when working procedures of standard-setting bodies and conceptions about economic life behind the standards are in conflict with realities and conceptions among authorities and political bodies representing general economic interests. The pace of decisions is different from normal and rules may be changed quickly. This is hardly astonishing. Standard-setting bodies develop rules for reporting. After all, certain accounting measures are basically one form of symbolically representing states and events. In a few cases such gaps have developed when unit-specific events and states have not been the bases of signifiers.

Connections between external and internal processes

The growth of an organisation is dependent on the nature of the horizontal flow and how the vertical process is connected to this flow. For pay-driven organisations, including transfer-driven, possible in- and outflows, their time pattern, uncertainty and risk are key variables. Growth is essential in several respects. For purely pay-driven and transfer-driven units, share value-in-exchange is significant. Growth in cash flows that are available for dividends has a strong impact on this value. In turn, such growth requires that activities are expanded and rearranged. Consequently, the development of existing business areas and the search for areas and new geographical markets are strong driving forces. Selection and pricing are two powerful mechanisms; prospects in terms of revenues and costs set limits for future development. Expansion is organic or is built on mergers and acquisitions – financial control concepts and processes in the decades around the year 2000 tended to support market transactions. For pay-driven organisations, financial capacity is based on previous values-in-exchange for input and output, surpluses in horizontal processes and attraction on vertical principals and lenders through expected surpluses. Exceptions are possible.

The Board and central executives have to consider if and how internal objects, measures and requirements should be linked to external demands. Objects as such must be chosen with this aspect in mind, possibly paying regard to what objects would facilitate external understanding and evaluation. Furthermore, measures and targets may be designed as a replica of external components. For example, there are various ways to formally consider the rate of return on equity requirements from owners.

Since the last few decades of the 20th century, many forces have induced connections between public and internal measures of companies. Mostly, public measures have been the determining factor. One expression of this development is that external periodical measures frequently became the norm for the design of internal periodic measures. Beyond this, periodical measures of a traditional kind lost some of their weight internally. Instead, value-based measures attracted more attention: calculated values of the same kind as at any

evaluation of companies and shares. Such values for separable parts of organisations became more important in internal control as well. As previously noted, public measures for entire organisations have tended to be designed with an exchange perspective. They may therefore be difficult to reconcile with internal measures that should be relevant for ongoing and lasting horizontal activities.

To a varying degree, internal control systems record and react to variations in the surroundings. Not only in the private sector, processes for the evolution and design of control systems of an organisation often mean that external functional modes and tendencies are captured and built into the system. In this way, organisations not only create opportunities to satisfy immediate demand but they also tend to strengthen certain outside values, views and habits.

Individual and collective needs and desires are the ultimate bases for the requirements placed on organisations. Outcome, on the other hand, is determined by how a certain potential is utilized. In principle, a discrepancy between the two is natural. Vertical tensions arise. Requirements from a generation of savers may conflict with working conditions of a younger generation. At the highest vertical levels, needs and external interest are in focus. At the highest well-organized level, decisive premises are established. A hierarchy contains various levels where room for action appears and is consumed. Mobility is most valuable at those levels that have an essential, potential impact on horizontal flows, either pro-actively or through adaptive behaviour, for core activities and relations forwards and backwards. It is not equally important at other levels. Mobility is dependent on capacity for resistance. Each level has its exposure to variations in financial development and repercussions of exogenous factors. Continuous mobility at a certain level is conditioned by how financial variations hit the unit and to what extent the unit is equipped to meet such variations. Operational consequences may vary. Capacity for resistance, for example through reserves, fulfils a purpose especially at levels where mobility has an essential impact on horizontal flows and facilitates adaptive behaviour, in both the short and the long term. At each level, people tend to regard their own reserves as motivated, but not reserves at lower levels. In accordance with this idea – and due to the shift of vertical processes upwards – group-level reserves now tend to be strongly questioned.

The status of the controllability concept weakened towards the end of the century. An outcome focus predominated: concentrate on the outcome strived for, link it with strong rewards and sanctions, do not make the relationship between resources and outcome a primary consideration, stimulate adjustments to factors that cannot be affected, restrict what are regarded as obstacles. Several currents of opinion worked along this line. Methods for achieving goal control became common during the second half of the 20th century. Reward and bonus schedules received considerable attention, particularly since control at a distance had become an important phenomenon during the last decades of the century. According to the logic of the most intense and popular parts of the public debate, it was also possible to relate guilt for deficient outcomes to actions of individual parties, and guilty individuals were preferably pointed out, regardless of controllability in its original sense. These tendencies increased towards the end of the century, at a time when interdependencies in economic life were increasing and parties that could act independently of each other were more difficult than ever to find.

Organised examiners and supervisory boards

Reviews by auditors, year by year, are important for financial control. Despite all the discussions about independence, auditors can hardly have a neutral role. Primarily, they

reinforce a vertical perspective at the cost of horizontal perspectives. After ownership and management had been separated around the year 1900, auditing was introduced as a tool for owners to monitor company and central executives. Auditors pay great attention to internal control in organisations, which in practice means emphasis on hierarchies and a vertical perspective.

The question is then whether auditing work supports any particular vertical level. Fundamentally, this work is supposed to benefit high vertical levels – owners or potential owners – while real procurement and charging of costs occur at lower levels. In their marketing activities, auditing firms may be encouraged to point out other benefits than the value of review as such. At various levels, organisational representatives have certain tendencies to regard auditing as a tool for their own information needs. In actual fact, the contents of the structure and systems that auditors are obliged to review influence what vertical level they support. The general shift upwards during the past few decades has meant a gradual change. During the first years of the 21st century, auditors have tended to support higher vertical levels than before, when the survival of organisations was a more important aim of systems.

Auditors have to consider whether an organisation complies with compelling norms, especially reporting principles. Nowadays, both rules and business transactions are complicated. Moreover, auditors have to take a position on valuations that are based on presumptions about the future. Looking at past events is not sufficient. Thus, there are zones of possibilities for judgements of an auditor. They are made at a distance. When a relation between auditors and organisations extends over time, auditors acquire a capacity to argue with executives on a more symmetrical basis in terms of insights into activities.

Besides organised examiners, supervising boards have regular duties. These organisations are part of public administration or private institutions with power to determine sanctions in a wide sense, not necessarily with direct reference to certain rules of law. Often, they have to judge whether organisations have complied with rather general system rules or not. In case of deviations, another type of norm defines when and how sanctions should be imposed. Overall supervision of financial institutions is important as well as the supervision of financial-reporting compliance for every kind of business groups. For supervising bodies as well, distance is an issue, normally greater than for an auditor. A thorough basis for decision-making is required, especially about future-oriented judgements. Superficial descriptions close to the content of expressed norms tend to be a risk. International capital markets make surveillance systems extraordinarily complex.

On certain occasions, examinations and supervision are starting points for purely legal cases. The outcome may then be affected by how descriptions and legal norm are connected to each other. Two approaches can be identified. According to one approach, descriptions as such are strongly influenced by legal norms that comprise statements at an abstract and high level about acceptable systems norms and possible sanctions. According to the other approach, descriptions or counter-arguments are influenced by an actual logic of activities in the organisation concerned but, in the end, norms will be fully applied. Thus, legal procedures will produce simple descriptions or more complicated ones that are closer to the logic of activities. In both cases, strictly legal judgement is not sufficient. Legal responsibility tends to converge towards individuals that, on the one hand, have had some room for action in an organisation and on the other hand, at the same time, have conducted some concrete acts within this frame. They may, for example, have signed a paper or unquestionably participated in a tangible decision.

Comparability

Financial accounting measures capture extremely complicated processes in a few numbers. Reported numbers are compared, over time for a certain company, in relation to other companies, or both in combination. Periods and companies are evaluated in terms of some general quality of relevance for many periods or companies. Comparability with regard to financial control is about the relationships between signified events, concerned functions and signifiers. One issue is the role of detailed reporting standards.

Contexts of accounting comparisons may be rather simple. A measure indicates values of a common dimension. This general quality is separable in company processes from a latitudinal point of view. A separate, critical and common function of company processes is identified. Processes are uniform, that is, the same kinds of events and transactions have a similar role for this critical function, at the same time or over time. They have reached similar stages in different companies, or are repetitive in a certain company. What has been done is terminated in the sense that the future outlook is not especially important for evaluation. Differences of signifiers in uniform terms correspond to observable courses of signified events that are outside the accounting system and important for critical functions. In such cases, detailed reporting standards undoubtedly facilitate direct comparisons.

Normally, however, relationships are more complicated. Organisational processes accomplish mixes of functions that are not the same for all units. Often, processes are not uniform, not repetitive and have not reached similar stages in different companies. On the contrary, the character of organisational processes and how it relates to various functions changes over time or is different for different companies. The way to critical functions in common and abstract terms may be very different. The broader the set of compared companies, the more obvious this fact is. Financial analyses of companies in all industries may serve as an example. In the end, cash flows and risks are of primary importance, but determining, intermediate factors are different for different companies. On-going processes are not terminated and an evaluation of what has already been achieved requires a prediction of future events; natural uncertainty is material. Changes of signifiers for a company over time do not necessarily correspond to changes of signified events; historical cost depreciation may serve as an ordinary example.

Some components of accounting measures are signifiers of events that are not unit-specific or signifiers of results according to a pure model. They may reflect economic value concepts that have not been manifested in the specific company, at least not yet. Deviations from unit-specific events may have far-reaching implications. The relationships between legal, observable form and substance in a deeper sense are not simple. Often legal form is essential for substance in some respect and for some function.

It is hardly meaningful to speak about comparability in any one-dimensional, absolute sense. Rather, interpretations are dependent on analyses of the relationships between signifiers and functions of various kinds, and especially how signifiers reflect qualities that are fundamental in the sense that they are common and essential for critical financial functions and operations. An important aspect is if motives behind comparisons are requirements with perspectives of needs or potentials.

There are reasons both for emphasizing signifiers and for recognizing their limitations. One question is how detailed, formal reporting standards affect comparability in a complicated context. The more detailed general standards are, the more probable it is that factors that are important for the critical functions of an individual company will be relatively under-emphasized. On the other hand, detailed and consistent standards could be a

framework to relate to when particular circumstances are discussed. But unambiguous comparability is somewhat illusory, even if signifiers are designed according to uniform and strict rules.

A tendency towards instrumentalism

Ultimately, control systems should be viewed in relation to the material and experiential functions of people, the operational functions of organisations, finance functions and various external functions of larger systems. The basic character of these functions is vague and mostly difficult to operationalise. However, the impact of control systems on these functions is conceptually essential. It represents intentions and effects of a first order. Underlying conflicts of interest and views are common, which is reinforced by the fact that various interests of a certain human being are split between many organisations in a non-coherent way. Distributional conflicts and ethical dilemmas are unavoidable.

Introducing money into societies meant a dramatic change in possible forms of allocation: a new, albeit very crude instrument. Organisations and professionals made instruments develop, which improved allocation and follow-up processes remarkably. However, instruments also tended to have less contact with the original intents and effects of the first order. They could fulfill a mission of that order but, in addition, they tended to become ends in themselves. Financial control systems in the early 21st century can be regarded from this point of view.

Rules for measuring, for decision-making and for financial constructions are developed. For example, values according to international financial reporting standards or according to international valuation standards are produced. These tend to be ends in themselves, even when they are not legally cogent. They represent intentions and effects of a second order. This is a common phenomenon. Achieving the numbers measured may be the decisive factor, rather than objectives in any deeper sense. “What gets measured gets done” – fortunately and unfortunately. It is almost always possible to count; conceptual meaning, however, is another matter. Here, too, lies a dilemma. Those factors that are fundamental but not meaningfully operationalised are easily neglected in favour of peripheral factors that are quantified. Efforts to satisfy the demands of interested parties can extend so far that intentions are not achieved, precisely for that reason

The first two orders may be difficult or complicated to apply. Especially in those cases, methods and processes, as such, can also become ends in themselves or at least be of prime importance. Thus, they represent a third order of intentions and effects: how to design financial reporting standards, how to determine accounting values in individual cases, how to design valuation standards, how to determine individual values according to certain standards. Many organisations develop competence for managing processes. An organisation that is highly sensitive to external demands may even develop, as its decisive competence, an ability to handle the communication process, as such, in which organisational performance meets external interests. Organisations that are devoted to third-order intentions and effects, or dependent on them, have become very common.

The very existence of processes, and processes as such, may be a main concern, beyond their actual use as instruments for first and second orders. Thus, a fourth order of intentions and effects is established. References are made to the fact that there is a process to talk, communicate and convince, almost irrespective of background and particular effects. International reporting and valuation standards may be good examples.

I regard the mass-media processes as so decisive that I identify a fifth order of intentions and effects. What would things look like in a mass-media perspective? Some professions are

establishing processes from that point of view. Symbioses of opinions become common. Parties benefit from sharing each other's opinions, or at least sharing the interest of the fourth-order intentions and effects. The mass media represent a form of external control in addition to internal control systems that are applied within organisations. It is reasonable to think that public dramas stimulate extensions of expensive rituals and formal systems in society and organisations. Both political and commercial organisations can go a long way in this direction. Mass-media output has an immediate use value for consumers looking for entertainment, as a part of their lives separate from everything else. Obviously, this aspect of public information has become more and more important.

SPECIFIC HANDLING PROCESSES AND TIME

A fourth latitudinal area depicts the specific processes of individual organisations for a certain issue. At the organisational level, subjects consider and interact with other units and individuals, controlling their own activities. Measures are taken with short- and long-term consequences for the organisation and its surroundings. Often, such processes are extremely intensive while they are going on but difficult to remember and describe in detail afterwards, and not least difficult to provide with an unambiguous context.

Long-term development of structure and control systems

The basic condition for each handling process is the structure and control system on each occasion. Financial realities and ambitions were undoubtedly driving forces of long-term developments in structure and control systems during the 20th century. In business life, changes in forms were profound. The shift of influence upwards in vertical processes led to an emphasis on volatile security prices, expectations and predictions of exchange values. Ideas for optimizing within separate and defined formal boundaries were strongly established. Relevant risk was related to these ideas, not to the survival of individual organisations. This became true for many non-financial companies and mostly for the growing number of financial organisations. All these organisations have their own separate risk, but some risks are shared with other organisations through many interconnections. For many of them, and most obviously for transfer-driven companies, expectations and exchange values are of crucial importance for mobility. Volatility is potentially strong, due to processes for public expectations and trading conditions and is not necessarily related to fundamental states. In rising markets, positive expectations make it natural to gain from optimizing with a certain view on risks and other traditional driving forces in business. At the same time, potential fluctuations in exchange values and public expectations expose financial institutions to the risks of sudden decline and immobility.

Thus, expectations, potentially volatile values-in-exchange of shares and risks that are related to shares became the foundation of impacts on companies. The risks not to survive, financial power and mobility at group level were no longer a main consideration. For non-financial activities, both public financial reporting and views on group financial structures expressed this development. Capital structures should be optimized, not targeted with regard to group and company survival. Explicitly and implicitly, the importance of groups in the previous meaning decreased. In addition, the identity of organisations changed and was split up. Organisations as such could have a turbulent life, while brands and identity went another and separate way.

A few decades ago, theoretical concepts like "a nexus of contract" had appeared as

detached labels of a living organ. Later on, they seemed fairly descriptive. Ties, backwards and forwards, were less strong and durable, including personal ties. Operational interdependencies within group were less important. With regard to transfer opportunities, the aim could even be to avoid them. Many organisations narrowed their operations, though sometimes on a broader geographical scale, and each activity was more directly connected to separate financial conditions. In developed networks, the way of relating visions and ideas to resources is different from that for hierarchies. Lateral coordination is required; basically, decentralisation in an established hierarchy is not possible. Each unit has to play its role in the network and, at the same time, those who have mobility at their disposal may exercise strategies of a good value-in-exchange.

Ex-ante stage, conduct and reporting

During a period of conduct, various activities within an organisation are carried out and immediate functions are fulfilled, or are close to being fulfilled. In advance, a certain period is considered in planning, budgeting, stock-price setting and so on. The outcome is reported step by step. As a result, what has happened during a period of conduct has further effects in an ex-post stage.

One of the main functions of continuous information is to provide data enabling decision-makers to cope with the uncertainty that gradually diminishes as periods, initially distant in the future, come closer and closer to reality. Requirements and expectations follow one another in a series before the conduct. Many of the most intense moments are just before the conduct period. The shifts upwards in hierarchies have meant an increased emphasis on expressed ambitions and intentions, not least in public communication. In stock markets, ex-ante evaluations and re-valuations of future development attract considerable attention. Often predictions are mere extrapolations of past development, but sometimes they have solid foundations of their own. Furthermore, stock prices can be determined through rather pure trading elements, where volumes on certain occasions are based on predictions of values-in-exchange in the short and long term.

Of course, conduct is a very tangible matter for organisation and workers but, from the financial principals' point of view, events could rather be regarded as a confirmation of expectations, and, exceptionally, as an impulse to take certain actions when expectations are not met. Nevertheless, formal reporting afterwards is extensive. In the majority of cases, relationships between efforts and costs of reporting on the one hand and utility on the other hand can be questioned. When an outcome is strongly unaccepted, past periods will attract far-reaching attention in the public forms implied above. Exaggerations and imperfections of the individual case tend to be in focus, rather than fundamental issues and behaviour that are common for many cases.

Continuous measuring points have become increasingly frequent, and the intensity of actions has also increased. More actions are initiated, with repercussions far ahead in the future. Fundamental issues, however, are extensive and complicated, especially in relation to the narrow problem pictures presented in the short-term reports that are an essential driving force in the management process. Actions may take place against a background of demarcated perspectives for activities and financial matters, rather than after analyses of connections in any deeper sense. Powerfulness is evident and based on the strong logic of control systems. A basic question is whether those systems promote exchange perspectives or use perspectives.

Effects of organisational handling

Often, organisational handling can be described as local optimization. Determination is strong within latitudinal boundaries. Moreover, handling may be time-bound. Longitudinal boundaries play a role, tending to reinforce determination effects. However, areas affected, outside and inside an organisation, contain not only rapid and visible variables but also slow variables whose signs are less visible and more ambiguous in the course of events. To some extent, it is not known what areas are affected and what character they have; this is truly uncertain. Physical and biological processes are continuously running irrespective of whether they are sufficiently identified or not and irrespective of what the human views are. As I use the terms, local optimization is different from sub-optimization, which requires a defined entirety with some form of goal function. Such conditions are often not prevalent. Obviously, control systems affect important states inside and outside an existing organisation. Such connections may be conceived logically, but they are often difficult to observe empirically, especially at a distance.

PRESENT FUNCTIONS AND TRANSFORMATION – VIEWS ON FINANCIAL REPORTING SYSTEMS AND STANDARD-SETTING

Control systems that relate functions and visions to resources basically influence immediate activities and experiences. In addition, they affect transformation for the future: the ability to fulfil functions, deal with novelties, escape dysfunctions and adapt to disturbances. Control systems develop over time. Below, I will discuss the financial reporting and standard-setting from this angle.

Functions and instruments

Organisational actions today concern functions today and also the conditions and outlook for horizontal activity in the future – for a single organisation and for larger systems, including natural resources. Structures and incentives are constructed to improve existing functions and their efficiency. Novelties are stimulated. But there is also vulnerability – for individuals, single organisations, nations, multinational areas and the entire global system. Actors and systems, at all these levels, are exposed to variations in horizontal events and have some adaptive capacity. Moreover, to varying degrees, each nation, organisation or individual is financially dependent in the sense that their financial functions are sensitive to variations in supplying financial markets and allocation systems. The possibility of such variations constitutes financial uncertainties for them and for larger systems and interacts with horizontal uncertainties. Again, at all these levels exposure to various operational, financial and total uncertainties and adaptive capacity are key variables.

Over the past centuries, material living conditions have improved dramatically. Industrial and political developments from the mid-19th century onwards meant fundamental changes that both raised material standards for the majority of people substantially and generated new constructions for the distribution of wealth. Control systems have contributed, especially by stimulating and promoting technological innovations and their diffusion processes. In this sense, the Western economic system and its financial control system have been strongly instrumental since the Industrial Revolution.

Originally, control instruments were rather simple and directly connected to concrete aspects of organisational life. Financial control systems developed over time, not least financial reporting. By and by, they became technically sophisticated. They captured more, but on the other hand they tended to be less connected to obvious and concrete circumstances of specific organisations, and moreover, they focused less on ultimate purposes and functions. Expectations and prospects became a dominant part of financial control systems. These were not centred around organisational circumstances as such but were more connected to external forces, upwards and forwards. They were critical in many vertical and horizontal processes. Opportunities and alternatives were stimulated and favoured without strict boundaries. The time horizon was essential.

For a long time, control systems have had fictitious elements. Group accounting is built on the illusion that a parent company has a direct relationship to assets and liabilities in subsidiaries, even though this is obviously not the case. Fair values in financial reporting can be based on opportunities and prices that are not presently considered by the specific company and will never be considered. Valuation techniques in corporate finance may be based on verbal model markets that will not signify any actual conditions in which values-in-exchange appear. Expectations at one point in the time are compared with expectations on a later occasion or values based on hypothetical premises, for example risk measures with a historical background. Uncertainties are converted into calculable risks. Many such elements can be an ingredient of standards that companies have to comply with. As a whole, prospects rather than retrospect have more and more become the nature of financial control.

Focus on instruments and the sophistication of instruments provide possibilities for progress but also create a potential problem: an over-emphasis on methods and processes in relation to underlying purposes. Each primary move towards sophistication soon leads to a subsequent step with its own secondary purposes as an end in themselves.

Functions and financial control for organisations

For me, the starting point is functions rather than control methods. Generally speaking, financial control systems for organisations are constructions for handling economic scarcity: how functions and visions are related to resources. They are instruments for dimensioning, for activity orientation and for efficiency. Organisational behaviour is a systematic, continuous force. Partitioning is combined with force. Often it is not primarily a question whether there is sub-optimization in relation to a defined entirety; it could rather be described as local and time-bound optimization in relation to partly uncertain and only partly defined areas of significance. Control systems and measurements are fragile in relation to most problems but are applied in a mode of energetic and forceful focus on explicit measures, targets, limits and processes of the separate unit that they represent. An intense hands-on mentality, sometimes at a distance, at high speed within narrow boundaries, has become common. Only marginally are wider repercussions parts of an agenda. Separate perspectives are often strong and time horizons relatively short. Sometimes attention is attached to one single aspect, measure and target, or at least only a few, that is central to this perspective, functioning from a communicational point of view. All these factors may be regarded as obstacles to adaptive behaviour.

Financial control issues can be discussed in terms of a few basic issues. ***The horizontal issue:*** what do states and flows in the horizontal line look like? Some forces are opposed to each other in this line. The first is efforts forwards to satisfy a user – and ultimately an end consumer. The second is the interests related to organisations. The third is considerations backwards. ***The vertical issue:*** what do states and flows in the vertical line look like? Two

forces in particular are at work in the vertical controlling process. The first is that current functions and renewal are achieved by continuous, permanent organisations. The second is the perpetual search by financial principals for new alternatives for future functions and for vitality in existing organisations. ***The reinforcement issue:*** Vertical processes and horizontal processes reinforce each other. How is this done and what are the effects?

The hierarchy above operational activities manages all issues concerning stability and change. The vulnerability of the organisation as such may constitute a varying concern. The background differs: what events actors at different levels are in touch with, what bases of knowledge they have and what alternatives they consider. Will upper levels, perhaps, focus on vertical and horizontal procedures and on repeated structural changes, rather than on horizontal activities as such? What will be supported and what will be prevented? Lower levels will have a stronger focus on developing these activities and improvements from that point of view. They have no immediate reason for considering any other functions and visions. Introducing market values and approximate equivalents in financial accounts represents a basic move. The penetration of transformation processes within the existing structures of an organisation is not primarily supported, rather some unspecified alternative use.

A substantial number of organisations are, directly or indirectly, occupied with financial allocation systems such as financial markets. A large proportion of actors in emerging structures and control systems have weaker contacts than before with low-level, non-financial horizontal flows. Intermediate levels have grown – larger and larger groups of people and organisations that are specialised in administrative, financial, communicative and controlling techniques. These have been regarded as extremely important, there have been great ambitions to create incentive systems to direct and reinforce their work on a local and time-bound basis. Traditional control subjects have lost some of their weight, both group executives and national leaders. Power has moved upwards – to the representatives of owners and super-national bodies, respectively.

Control subjects and objects

There is no easily located responsibility for an economic system in its widest sense; self-organisation takes place to an essential extent. It is difficult to define the state and nature of the widest economic systems, including uncertainties. Moreover, it is a dominating fact that no one can be said to represent an obvious entirety and overall interest, irrespective of separate interests. Nevertheless, formal and informal control subjects exist – special organisations within the public or private sphere and the mass media that in fact play a controlling role. They cover some control objects and/or some more or less well-defined economic system. Some of them, such as financial reporting standard boards and valuation-standards setters, are established to fulfil a certain control function. This type of information requirements basically supports certain kinds of local and time-bound behaviour and may change in character over time. To some extent, however, the contents and norms of public information systems emerge in close relation to business transaction activities and information technology opportunities, rather than being determined by any formal control subject.

Control subjects have their targeted areas of significance. But there are also residual areas: functions and dysfunctions, in general or for certain groups, that are affected when other aspects are targeted. Uncertainty and lack of visibility is fundamental for critical

relationships in and around most organisations. Most financial accounting measures, including income and value concepts, are bound to be rough, but important, indicators in the critical financial processes and in relation to critical functions. Not least uncertainties of processes and functions contribute to that. For these simple reasons, notions of transparency and perfect information are not very natural reference points when control systems are to be designed or described.¹² Not even comparability is as self-evident as it may seem at first. Views on comparability mean certain control perspectives: for whom and for what is it essential to compare?

The infrastructure and restrictions for business organisations, horizontally and vertically, are to an increasing extent a concern of super-national or international bodies. In the public sphere, a super-national level is above every national level. Nations do not exercise autonomous control to the same extent as before; rather they too are controlled as a part of a greater collective. At the super-national level, there are temporary projects and permanent, function-driven organisations that are exposed to general mechanisms. There are obvious difficulties in organizing powerful control subjects at really high, super-national levels where global problems can be addressed.

Control of controlling organisations

As all organisations, controlling subjects partly focus on separate and professional interests. All controlling organisations do, including authorities and the mass media. Often, control subjects may themselves be working within a system where competition explicitly prevails in various respects. They are parts of a complicated vertical and horizontal structure, and this is the case even more when problems and organisations extend across national borders. Standard setting and supervisory bodies are not exempted from general mechanisms that any function-driven organisation meets, including financial restrictions. Thus, also for the design and evolution of control and surveillance systems as such, target-oriented driving forces are essential and processes go on that have many similarities with any user-oriented process, whether commercial or not. Everybody tends to focus on the articulate vertical and horizontal interests around them, often, but not necessarily, to be in conformity with the surrounding actors.

One important question is the extent to which control bodies pronounce standards that are based on their own broad basis, and to what extent their position reflects the views of outside actors. For example, accounting standard setters may have the view that financial reporting should be useful for a certain group like analysts, and they may try to capture analysts' views. This is only one way of reproducing one type of separate views at one point in time, rather than trying to identify what would be functional for the economic system in a broader and longer perspective. It is not necessarily a good idea to let a standard setter construct accounting rules with the needs of "decision-makers" as the main guide line. If this ambition is fulfilled, the current views of such decision-makers will be built into the control system, which does not mean that the system will be appropriate for future situations of a very different character. Application problems are obvious for systems that are not very robust,

¹² The opposite view is apparently more common in financial accounting literature. See, for example, Barth & Schipper, *Financial Reporting Transparency*. They propose a definition with representational and users' perspectives: "the extent to which financial reports reveal an entity's underlying economics in a way that is readily understandable by those using the financial reports". Barth & Schipper do not discuss conflicts of interest, nor the distance problem or any contextual problems. They argue that transparency is "a worthy goal", because the cost of capital tends to be reduced.

which is the case with many rules based on predictions. Implied effects may also appear in the long run, such as the distribution of power among owners, boards and central executives.

Designing a control system in a technical sense means partitioning. Areas of significance from a broader system's point of view are not considered. This may be natural from a professional point of view, but the effects of norms can be far-reaching and may include aspects that norm setters would regard as irrelevant for them. Rules and procedures for determining the rules may cause inconveniences for greater systems of an uncertain and less well-defined nature. Systems complexity means that part-driven and far-going norm setting, on the conditions of a few professions, makes residual effects probable sooner or later. It is possible that strong control from high organisational levels is not feasible. Uncertainty is unavoidable, and in some ways instability is even productive for general development. Control systems may be constructed with this in mind. Then, measures, targets and processes should not be designed in detail, as if that would take care of uncertainties. An economic system with many areas of significance requires many aspects to be considered simultaneously, on a continuous basis and on urgent occasions. Lack of balance and robustness is a problem, especially in the long term. Strong emphasis on a few measurable variables in current activities creates biases, as do strong central regulations from a narrow perspective.

Research

It cannot be ignored during the early 21st century that among accounting researchers there is growing interest in the relationships between “real world problems” and academic research – perhaps even a questioning attitude. Most research efforts have a specific and rather limited perspective – partitioning is common in research, too. Insights may no doubt be gained within such frames. However, clarifying perspectives and approaching integrative, linking issues are important strategies, if complicated real-world problem solving should be based on social research. Conventions and models beyond inter-subjective empirical rigour need to be approached in an analytical spirit; the actual, current roles of researchers often seem to be supporting and inventing new conventions and models.

Often, explicit conclusions are too far-reaching, especially if they are transformed into something that is communicable to larger audiences. Social research, like other informational activities, includes story-telling exercised by a profession in relation to target groups in lecture rooms, media of various kinds – including academic journals – and the world of practical conduct. Complexity, rather than over-relativistic simplicity, should be a line for descriptions in social research, especially with respect to long-term effects. In many ways, research is exposed to the same mechanisms as other informational ventures.

REFERENCES

- Barth, Mary E. & Schipper, Katherine, *Financial Reporting Transparency*, Journal of Accounting, Auditing & Finance, 23, no 2, 2008.
- Baumol, William J. & Bowen, William G., *Performing arts – the economic dilemma: a study of problems common to theatre, opera, music and dance*, New York 1966.
- Beattie, Vivien, *Moving the financial accounting research front forward: the UK contribution*, The British Accounting Review, 37, 2005.
- Ferguson, Niall, *The Ascent of Money: A Financial History of the World*, London and New York 2008.
- Gunderson, Lance H. & Holding, C.S., eds., *Panarchy. Understanding Transformations in Human and Natural Systems*. Washington 2002.
- Habermas, Jürgen, *The theory of communicative action*, Boston 1987.
- Hayman, Ronald, *How to read a play*, New York 1999.
- Ijiri, Yuji, *The Foundations of Accounting Measurement*, Englewood Cliffs 1967.
- Johansson, Sven-Erik & Östman, Lars, *Accounting Theory – Integrating Behaviour and Measurement*, London 1995.
- Östman, Lars, *The long range dynamics of financial control. The Royal Dramatic Theatre and its costs over a century*, SSE Working Paper Series in Business Administration, swoba.hhs.se, 2007:1.
- Östman, Lars, *Towards a General Theory of Financial Control for Organisations*, Stockholm 2009 and SSE Working Paper Series in Business Administration, swoba.hhs.se, 2009:9
- Power, Michael, *The audit society: rituals of verification*, Oxford 1997.
- Scapens, Robert W. & Bromwich, Michael, *Management Accounting Research: the first decade*, Management Accounting Research, 12, 2001.
- Watts, Ross L. & Zimmerman Jerold L., *Positive Accounting Theory*, Englewood Cliffs 1986.