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EXPLAINING THE CHOICE OF ACCOUNTING STANDARDS IN MUNICIPAL CORPORATIONS: RECONCILING POSITIVE ACCOUNTING THEORY AND INSTITUTIONAL THEORY*

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ABSTRACT

Positive Accounting Theory (PAT) has been claimed as offering the only theory capable of predicting accounting choice. We indicate through the deduction of hypotheses regarding Swedish municipal corporations that institutional theory (IT) not only is capable of creating predictions, but even of complementing PAT. Through testing the hypotheses on a sample of 545 municipal corporations, we show the empirical relevance of both PAT and IT. We conclude by suggesting a synthesis of PAT and IT in an eclectic alternative.

(79 words)

KEYWORDS

Accounting choice, Positive Accounting Theory, Institutional theory, Municipal corporation

INTRODUCTION

A scientific accounting theory should be able to explain the actual choices of accounting standards made in the economy by economic agents. Some while ago it was stated that such a theory would have to have a certain point of departure: "...the only accounting theory that will provide a set of predictions that are consistent with observed phenomena is one based on self-interest" (Watts & Zimmerman, 1979, p.300). This theory has become generally known as positive accounting theory (Watts & Zimmerman, 1986), henceforth abbreviated PAT.

PAT has been subject to extensive critique and heated debate (e.g., Milne, 2002). Recently Zimmerman (2001) opened the front again with a wish that a unifying theory should emerge, but as a matter of course it should be based on economics. A year later contesters had gathered their troops and organized a debate forum aimed at the Zimmerman 2001 piece (Hopwood 2002, Ittner & Larcker, 2002; Lukka & Mouritsen, 2002). To be sure, science can develop fruitfully through the dialectics of negation. The present debate is, however, rather unfruitful, creating trenches of self-sufficiency instead of theory development through conceptual synthesis or fair competition through empirical evaluation or testing (cf. Holthausen & Leftwich, 1983; Luft & Shields, 2002). According to our knowledge, only Neu & Simmons (1996) has made an effort to empirically test a synthesis of two or more theories. They infused social relations and context into a PAT explanation and tested the theory on site restoration costs.

As believers in scientific development through true dialectics, we will continue along the well-respected path of Neu & Simmons (1996) in searching for syntheses. The theories we have chosen are PAT and the sociologically oriented version of institutional theory as formulated by DiMaggio & Powell (1983), henceforth abbreviated IT. We have one conceptual and one empirical reason for our choice of theories. The conceptual reason stresses the complementary nature of the theories. Any ambition to create a theory of accounting choice has to acknowledge the economic forces facing individuals and the egoistic character of humans. PAT is the theory that is solely devoted to these characteristics. On the other hand, as the critics of PAT contend, a serious theory cannot disregard the human capacity to build collective phenomena, such as normative and cognitive set-ups, termed institutions, that restrain and facilitate the human capacity to interpret society and thus influence human choice and action. IT is a theory that has its focus on these collective phenomena. Thus, the choice of PAT and IT is a choice to focus on both the agent conducting the choice and the environment

influencing and even defining the individual and the possible choices to be made. Our method of synthesis will be to keep the theories separated and deduce predictions about accounting choice from them. The separate deductions will indicate their complementary nature. Then the predictions will be tested on a set of corporations and their accounting choices. The outcome of the empirical test will emphasize the weaknesses and strengths of the different theories, and thereby facilitate a productive synthesis of them. This synthesis, being based more on explanatory power than ontological purity, will therefore be eclectic in nature.

The empirical reason for selecting these two theories arises from the fact that the theories not only distinguish themselves from separate theoretical focus, but also from separate empirical fields. PAT has been extensively tested in capitalistic firms, particularly listed firms (Watts & Zimmerman, 1986), while IT has tended to be evaluated using data from governmental organizations (Carpenter & Feroz 2001), though there are few exceptions, such as Zimmerman's (1977) evaluation of a rudimentary version of PAT in municipalities. We chose to select data from organizations that do not belong to either traditional empirical field of the two theories. Thereby we hope to expose the theories to the toughest test possible. Our choice is the corporation that is wholly or jointly owned by a Swedish municipality. Swedish Municipal Corporations, henceforth abbreviated SMCs, are corporations that typically are governed by a board of directors dominated by politicians selected from the political assembly of the municipality (Collin, 2001). They have been organized in order to induce cost awareness in a municipal operation, to make the organization more alert to market demands, or to facilitate transfer of ownership through privatization (Ibid.). Municipal organizations differ from listed capitalistic corporations in one important respect, that according to the law of municipalities, they are not allowed to be organized according to a profit motive. They act in the twilight land of having the capitalistic organizational structure, but, at least formally, forbidden to be oriented by the capitalistic drive of profit-maximization.

Our aim in deducing hypotheses is to make them statistically testable. Zimmerman (2001) has claimed that there are few testable theories, while critics such as Lukka & Mouritsen (2002) and Chabrak (forthcoming) find statistical tests meagre. Our objective when deducing and testing hypotheses, not only from PAT, but also from IT, which is rather infrequent (Bealing, 1994), will be an effort towards rejecting both claims. Thereby the study will indicate that the productive way forward in empirical accounting research is probably not through limiting choice of empirical methods by hegemonic and ideological beliefs, but through pragmatically

finding relevant empirical methods (Neu & Simmons, 1996). Thus, we will test the PAT and the IT predictions on survey data of SMCs collected from the year 2001.

Accounting choice studies, however, have been occupied with the motives behind the accounting choice itself, and neglected the actual outcome of the choice (Francis, 2001). Our investigation will not deviate from the mainstream in this respect. We test our predictions through correlating the factor inducing the choice with the choice made, and not the actual outcome.

To summarise, our goal is to reject the initial statement by Zimmerman and his critics, and indicate that the path forward to develop the theory of accounting choice is through synthesising efforts and pragmatic choices of empirical methods.

The structure of the paper is as follows. The dependent factor of accounting choice is first presented briefly. In order to understand the choice made by a corporation, the reader has to be acquainted with the accounting tradition of Sweden and the opportunity set of accounting standards that are offered to the decision makers of SMCs. The next section contains the theory of the paper, where the collection of hypotheses from PAT and IT are derived. The method section describes the collection of data and the subsequent dataset. The analytical section presents the results from the logistic regression analysis. The final section of the paper analyses the results and draws conclusions about theory development.

THE OPPORTUNITY SET OF ACCOUNTING STANDARDS FOR SWEDISH MUNICIPAL CORPORATIONS

There are two acts that regulate Swedish corporate accounting, the Bookkeeping Act (in Swedish: *Bokföringslagen*) and the Annual Accounts Act (*Årsredovisningslagen*). Both acts are framework legislation. This means that the legislation contains only general principles about accounting and reporting. In consequence, the legislation must be supplemented by more detailed rules expressed as a ‘code of good accounting practices’. The expression ‘code of good accounting practices’ comes from the foreword to the 1976 Bookkeeping Act (prop 1975:104) and was defined as: ‘...an actually occurring practice among a qualitative and representative circle of preparers’ (Translation by authors). According to Jönsson (1985), practice does not mean commonly occurring among companies, but commonly occurring among well-respected companies. The concept ‘qualitative’ means that the preparers must use

generally accepted accounting principles and certain standards and rules within the area of accounting (Brorström, Eriksson & Haglund, 2003). A representative circle of preparers can be defined as a certain number of companies within the same industry, or in the same category of size or with similar conditions (Jönsson, 1985; Brorström, Eriksson & Haglund, 2003).

The overall standard-setting body in Sweden is the Accounting Standards Board (*Bokföringsnämnden*), which has the tasks of interpreting and supporting the development of a good code of accounting practice (SOU 1996:157). However, the Accounting Standards Board (ASB) has entrusted to the Accounting Council (*Redovisningsrådet*) the assignment of promoting a good code of accounting practice among listed companies and companies that, due to size, are of interest to the public. The Accounting Council's (AC) standards are primarily based upon the standards issued by the International Accounting Standards Board (IASB). Compared to the AC standards, the ASB standards are less detailed and are characterised by a higher degree of prudence and conservatism. The implication for a corporation applying ASB instead of AC standards will be lower cost for financial reporting and a tendency to show lower profit in the accounts.

Listed companies and companies that, due to size, are of public interest have to apply the Accounting Council's standards. All other limited companies with a business activity can choose between applying one of three alternatives: 1) The ASB standards, 2) the AC standards, or 3) a mix of ASB and AC standards. The choice of which standards the company applies should be clearly stated in the annual financial report (BFNAR 2000:2). Henceforth in this paper the abbreviations AC and ASB will be used when referring to the respective standards of Council and the Board.

The aim in this paper is to predict and test the propensity of SMCs to use either AC or ASB. Through using the set of standards belonging to either AC or ASB we avoid the empirical problem of accounting choice studies that focus only on one single method. It has been claimed that managers do not choose a method in isolation (Zmijewski & Hagerman, 1981; Watts & Zimmerman, 1990; Fields, Lys & Vincent, 2001), but they probably create a systematic view of the choices. Our selection of a set of accounting standards implies that we reduce this empirical problem.

PREDICTING CHOICE OF ACCOUNTING STANDARDS

A major purpose of this paper is to indicate the possibility of a synthesis of PAT and IT. This section is the grounding of the argument. Here we will derive predictions about accounting choice in SMCs based, first, solely on PAT reasoning, and then on IT reasoning. The section ends with a summary that shows the complementary nature of the theories.

Predicting accounting choice through the lens of Positive Accounting Theory (PAT)

Accounting can be perceived as having two functions: that of producing information for decision makers, such as shareholders, and that of distributing the results of production. Both functions have wealth effects for stakeholders of the organization. The information influences the evaluation of projects and the control of management (Bushman, & Smith, 2001), and its distribution influences wealth through, for example, determining the amount available for dividends. Stakeholders are therefore inclined to influence the accounting system of the organization. Positive accounting theory (PAT) has focused on this aspect of the accounting system, predicting the choice of accounting rules according to the wealth effects it has for influential stakeholders (Watts & Zimmerman, 1986).

PAT assumes that human behaviour can be explained by individual wealth-maximizing behaviour, implying that an actor will influence the choice of accounting policy to the extent that the choice influences the wealth of the actor (Watts & Zimmerman, 1990). Thus, the economic consequences of the accounting choice explain the motivation behind the choice (Holthausen & Leftwich, 1983). In a world of perfect markets, where information is costless, this would pose no problems. On the other hand, in a world where information is costly, there is no market for accounting information. Introducing the friction of costly information and the costs of gaining competence, i.e., to be able to evaluate the information and process it into a decision, implies that actors in the theory have to decide the level of investment made in both competence and in information.

An agent that is in a position to be able to influence an organization's accounting choice has to figure out the economic consequences of the specific accounting choice, and then to figure out how these consequences will affect the agent's wealth. Thus, there are two relationships—between accounting choice and economic effects, and between economic effects and the effect on the agent's wealth—about which the agent needs information and theories in order to be able to analyse the information and conclude what choice to make. Additionally, since

both information and theories are not perfect, one needs to include risk in the calculation. These costs imply that a realistic theory of economic consequences has to rely on the assumption of bounded rationality (Williamson, 1975), and with the implication that the intentional wealth maximizer will act as a wealth satisfier (Simon, 1957).

To be able to explain accounting choice with PAT, one has to identify the actors engaged in making accounting choices. In PAT, it is conveniently assumed that accounting is part of the contract between a principal and an agent. The two parties agree voluntarily on the set of accounting choices that can be made, and the adherence to the accepted set is monitored by the external auditors (Watts & Zimmerman, 1990). It is further assumed that there is a separation between the agent and the principal that is so extensive that the discretion of making the accounting choice is assigned solely to the agent.

The agent will make choices that maximize the wealth of the agent. PAT research has found at least three factors that influence the agent: the compensation plan, the lending arrangements, and the political visibility of the organization. The agent will prefer accounting choices that (1) increase the level of compensation, (2) increase the discretion of the agent through safeguarding lending agreements, (3) avoiding political pressure on the organization through suspicious profits. Empirical research has found support mainly for the compensation factor, and slight support for the political pressure, but only weak support for the debt covenants factor (Bowen, Noreen & Lacey, 1981; Fields, Lys & Vincent, 2001; Holthausen, 1981).

With regard now to the Swedish Municipal Corporation (SMC), PAT focuses our attention on the owner (representing the principal) and the top manager of the SMC (representing the agent). The owner is the political organization of the municipality, governed by the elected politicians. An inductive study of SMCs (Collin, 2001) found that the owners of SMCs had an interest in the corporate organizational form since it could fulfil three different functions: (1) an agent for rationalization of municipal operations, especially creating cost awareness in the organization; an agent for competitiveness, making the organization more alert to market demands; and finally the function of privatization, especially making it easier to transfer the company. Only in the case of privatization could profit be expected to be of major importance, since the profit of the corporation influences the price of the corporation. In the other two cases it can be assumed that the overall tendency of the municipal owner is to retain

the wealth in the corporation. The municipalities have no interest in profit; indeed it is even against the law for municipalities to have a profit motive. The motive of rationalization and competitiveness are both oriented towards fulfilment of a service, which presumably is fulfilled more easily if the surpluses are kept within the corporation. Retained earnings give the owner freedom of action to design the corporation according to its interest (Neu & Simmons, 1996; Lambert & Sponem, forthcoming).

Owners cannot, however, be considered to constitute a homogenous group of individuals. As in listed corporations with owners such as pension funds, with long-term investment horizons, and day-traders, with their extreme short-terminism, SMCs have owners that consist of individuals with differing interests. The politicians who represent the municipality on the SMC's board of directors can be assumed to prefer an accounting choice that makes conservative valuations in order to maintain or develop the capacity of the corporation. Politicians from another sector of the municipality, especially those who have to rely solely on tax money, could very well promote a less conservative valuation since it could lead to high reported profit, with immediate claims following on dividends to be paid to the municipality. It is an empirical matter to determine which group of politicians is most influential, but we make the simple assumption that politicians on the board have stronger incentives to implement their view since the advantage of lower reported profit can be used directly and without any dilution by the politicians on the board.

The politicians can, however, be regarded as agents in an agent–principal relationship where the citizens are the ultimate principals. Zimmerman (1977) found in one of the few PAT-studies of non-listed organizations, that voters can reasonably be assumed to have a rather limited interest in advanced accounting. The ultimate principals can therefore not be expected to influence the accounting choice of the municipality, let alone the municipal corporation.

Thus, we expect the municipal owner, and especially the representatives of the owners at the board of directors, to have a general tendency to support the choice of accounting rules that support retention of earnings, i.e., to prefer ASB regulations.

The top managers of the SMC can be assumed to share the interest of most other managers—that of growth, especially through diversification that can reduce the employment risk

(Amihud & Lev, 1981). Another reason to prefer growth is that managers gain status when they manage a large organization. Status can certainly be exchanged into wealth, but it can also be considered as a good of its own. Thus, when dealing with managers we need to transform the wealth assumption into the less precise assumption of utility-maximizer (cf. Zmijewski & Hagerman, 1981). The need to acknowledge utility as a motivator is emphasised when considering that large organizations offer complexity, which can be assumed to present a stimulating challenge for a manager, as well as constituting a factor that may reduce the control capacity of the principal, and thus increasing the manager's discretion.

Another factor that influences managerial incentives is the existence of an external managerial labour market. In order to improve their own employment opportunities, managers have an incentive to be visible on the external market for managerial labour. Probably size, not profit, creates visibility, since influence in society is a function of the size of the organization. Additionally, if one assumes that the managerial labour market tends to be segmented into a public and a private market, the profitability of the organization does not attract attention compared to the manager's capacity to manage a large and complex organization. Thus, managers of SMCs tend to prefer size, and therefore to support measures that lead towards larger size, including organizational growth.

One of the dominating motives for managers in listed corporations to prefer growth is the positive correlation found between wages and organization size (Gomez-Mejia & Wiseman, 1997). This, however, will probably not be the case in SMCs, mainly due to its public character. It has been found that public hospitals in the United States have less advanced compensation systems, with significantly less compensation than private hospitals (Eldenburg & Krishnan, 2003). This is comparable to the SMCs, where it was found that they tended to have reward systems that were similar to the municipality (Collin, 2001). The implication is that since the incentive system does not create a link between the top managers' wealth and the profit of the firm, top managers of SMCs can be expected to be less interested in reporting profit.

Finally, the threat of takeover, which could induce managers to present high profit numbers in order to avoid a bid on the corporation (Bushman & Smith, 2001), is virtually absent in SMCs. We would therefore expect top managers to be more prone to choose an accounting policy that retains earnings.

Summarising this discussion on the derivation of top managers' interest and owners' interest, we will expect to find a basic coincidence of interest between top managers of the SMCs and the municipal owners. These two parties will promote the use of the simpler rules of ASB since they tend to retain earnings. The overall hypothesis, based on ideas from PAT, is as follows:

HPAT1: Swedish municipal corporations will tend to use ASB regulations.

The presence of ASB could be due to tradition since ASB is the old way of accounting in municipalities as well as being the dominant method of accounting today. This way of reasoning has, however, been described as insufficient: "The alternative model begs the question of what determines the majority accounting choice." (Watts & Zimmerman, 1990, p.140). We will return to tradition and imitation since they constitute two major concepts in institutional theory, but we would like to stress that "business-as-usual" can be regarded as a rational choice. Holthausen and Leftwich (1983) argue that if there are no apparent benefits in finding a specific accounting method, it is rational to copy the mainstream method used by competitors. A more specific reason to follow competitors is that the market could interpret a deviation in accounting behaviour from the rest of industry as bad news (Inchausti, 1997). Thus, we can formulate the hypothesis:

HPAT2: SMCs belonging to the same industry tend to choose the same accounting standards.

It can also be rational to act traditionally, i.e., to do today what one did yesterday. In order to change policy, a firm needs to engage in finding alternatives through collecting information and theories about possible accounting methods and their economic consequences, as well as the effects on the utility of agents and principals. All these activities are, as Luft & Shields (2002, p.799) term them, "...costs of thinking..." which cannot *a priori* be regarded as negligible. Additionally, if a change is considered, the firm will have the accompanying costs of social innovation, i.e., the necessary resources and activities to implement and motivate an accounting change. Thus, if the economic consequences produced by an accounting change cannot be predicted to produce significant benefits for the agent, the organization will not consider accounting change.

This line of reasoning, emphasising the cost of thinking and costs of social innovation leads to the hypothesis that SMCs tend to choose the same accounting policy as last year. Adding information from the specific context of SMCs, i.e., the empirical fact that ASB is the “old” way of accounting in municipal organizations, we end up by repeating the first hypothesis, HPAT1.

Though the general tendency predicted by PAT is ASB, the theory can call attention to situations where this tendency will not be present. One of these cases is when an SMC is owned by several municipalities in a true joint company. Municipalities can engage in joint ownership, for example, due to economies of scale, such as sewage or waste disposal. The service in this example is rather straightforward, which implies that the actual service delivered is rather simple to monitor. Since the interests of the different owners cannot be assumed to coincide, it can be assumed that the scope for conflicting interests is kept to a minimum through strict corporate governance mechanisms, such as a very clear corporate strategy where the product and service areas are clearly defined, thus putting a limit on both the top managers and the board of directors.

With the possibility of intervention kept to a minimum, the owners are left with the interest of evaluating the efficiency of the operations. The accounting system can be of considerable help in this case since absent owners can use it as an information system creating standardised information (Bushman & Smith, 2001) that makes it possible to compare one organization’s economic performance with that of other organizations. A sewage corporation operating in several municipalities can be compared on costs and revenues with another sewage corporation or with other types of corporations. The more elaborate accounting rules of AC will then be preferred since they produce better information than the standards of ASB. It can therefore be expected that an SMC owned by several municipalities will prefer the more advanced standards of AC, despite their being more costly to apply, and a resulting, less conservative valuation, i.e., a tendency to show higher profit.

HPAT3: SMCs owned by several municipalities will have higher probability of selecting AC than SMCs that are owned by one single municipality.

Another exemption from the general tendency is the exercise of ownership power. Although we have claimed that the ownership can be divided into separate groups with differing interests, it cannot be disregarded that large and complex organizations, such as large municipalities, will exercise their formal power in a coherent way in order to make the organization possible to control. Complex organizations need to rely on advanced financial accounting information. This would make large municipalities prone to exercise their ownership power, overruling the politicians at the board and their interests, in order to implement an advanced system, presumably the more advanced standards of AC.

Indications of the need of more advanced accounting systems have been found in Stockholm, Göteborg and Malmö, the three largest cities of Sweden (Bergevärn, Melemvik & Olson, 1995). Over the years these cities have been the forerunners in accounting system development in the municipal sector. One explanation could be that, due to their mere size, they have an abundance of resources making it possible for them to assume the costs of thinking and social innovation, i.e., to invent and make experiments. However that explanation only tells us that they can assume the costs, not why they are willing to face those costs. One economic reason for their innovative activities is that the municipalities of the three big cities have grown considerable in size, creating problems of control, which are dealt with partly through improvement in accounting systems. Another explanation is that the need for elaborate financial information is greater in big cities compared to small municipalities. The big city municipalities consist of larger and more diverse organizations with many more employees, implying a need for more abstract information about the operations through a more elaborate accounting system and standards. The distance between the middle management and the top management of the municipalities is larger in the big cities than in smaller municipalities where social control is rather strong (Cassel, 2000). Decreasing social control puts presumably more emphasis on the monitoring capacity of the accounting system. The municipalities have employed highly qualified accountants in order to improve their control capacity. This represents a sunk cost, and will reduce the cost of thinking, and thereby increase the likelihood of choosing the more advanced accounting standards. Thus, we claim that in the three big cities of Stockholm, Göteborg, and Malmö, the need of control and the presence of advanced accountants will increase the probability that municipal organizational entities such as the SMCs will use advanced accounting techniques such as the AC. Thus:

HPAT4: SMCs owned by the three big cities of Stockholm, Göteborg and Malmö have higher probability of selecting AC than corporations owned by other municipalities.

PAT in its traditional form pays attention to three dominant factors. We have eliminated the compensation plan as an influential factor in the case of SMCs due to their primitive incentive schemes. We can also eliminate the influence of debt covenants since we believe that although SMCs formally are limited companies, they are regarded by stakeholders, including debtholders, as having unlimited liability, ultimately supported by the tax power of the citizens. Left are the political costs that are predicted to increase with the size of the corporation, creating incentives for large corporations to retain earnings and thereby lower the public interest of the corporation (Meyer, Karim & Gara, 2000; Zmijewski & Hagerman, 1981; Watts & Zimmerman, 1986). The SMCs can be assumed to have distinct political cost. If they show high profits, there is a high probability that other politicians in the municipality will put pressure on the corporation to distribute the profits to the other sectors of the municipality through dividends, or even to capitalise the profit through privatizing the corporation. Consequently the corporation, at least the politicians on the board of directors, will prefer conservative valuation. The managers will also prefer it in the case of the dividend, but may be more open to privatization, if it did not increase the employment risk. We therefore predict SMCs to prefer the conservative valuation found in ASB.

One objection to this prediction is that there is a regulation requiring corporations to use AC if, due to their size, they are of public interest. Since SMCs are owned and governed by a public governmental organization, they are all of public interest. This is, however, not an argument of economics, but of ethics and institutional theory, which we will return to later. The presence of a regulation cannot be foundation of a prediction in modern economics because of the presence of opportunism (Williamson, 1975). We have to ask what are the sanctions, i.e., costs of not adhering to the regulation. Additionally we can observe that the regulation gives considerable leeway since it demands an interpretation of the public interest. Lacking unambiguous precision and without formal sanctions, the probability of the regulation being in effect is low. Thus, we predict according to the main PAT-prediction, that with increasing size, SMCs will escape political costs through choosing ASB:

HPAT5: SMCs' probability of selecting ASB standards will increase with corporate size.

Summarising the PAT section of our predictions, we have found that the theory of economic consequences concerning SMCs predicts that they will as a general tendency use ASB regulations, which is enforced by the size of the corporation, that the SMCs in the same industry will choose the same regulations, and that AC will be preferred in two cases, that of multiple owners and when the SMCs are owned by one of the big three cities of Sweden.

Now we turn our attention to institutional theory, in order to find out what different knowledge can be gained about SMCs and their accounting choice.

Predicting accounting choice through the lens of Institutional Theory (IT)

Institutional theory, henceforth abbreviated IT, or to be more specific, the sociological oriented institutional theory (DiMaggio & Powell, 1991), as compared to the economic oriented institutional theory found in transaction costs theory (Williamson, 1975), offer in certain respects an alternative to PAT, but also, and foremost, a complement. In this section we present the basic ideas of IT and deduce hypotheses about SMCs. Though different in argument, surprisingly enough, most hypotheses will be the same, thus supporting our contention that PAT and IT are complementary in arguments.

IT, as it has been used in studies of accounting choice (Carpenter & Feroz, 2001) is based on the list of institutional mechanisms depicted by DiMaggio & Powell (1983) in their classic article. It is claimed that the institutional mechanisms that influence organizations towards homogenization can be divided into three mechanisms: (1) *Coercive*, inflicted by pressure from external organizations which the organization is dependent upon; (2) *Mimetic*, an imitation by modelling successful concepts in order to manage uncertainty; and (3) *Normative*, which stems primarily from members of a professional group's collective struggle to define the conditions and methods of their work.

The three mechanisms function differently, which is important to notice in order to fully understand how decision makers are influenced by institutions. The coercive mechanism is mainly a resource-dependency explanation. Organizations can put pressure on the focal organization to behave and to structure itself in a certain way; otherwise the focal organization will not gain the needed resources or will suffer from sanctions. The mimetic mechanism is partly based on the same reasoning as the one presented earlier as costs of thinking and social innovation. Facing uncertainty, for example, through poorly understood

organizational technology and mean–ends causalities (DiMaggio & Powell, 1983), organizations tend to mimic the successful ones in their organizational field, thereby hoping to perform successful activities, without really knowing it, and to act in accordance with other organizations’ expectations, thus being regarded as legitimate.

The *normative mechanism* is claimed to be performed mainly through professional groups promoting their competence in society. This mechanism can, however, be expanded to include all normative pressure on individuals, i.e., the taken-for-granted nature of institutional pressure. Both the coercive and the mimetic mechanisms can be regarded as having elements of rational choice, where an organization has the opportunity to make a choice, in order to acquire resources through compliance with other organizations’ demands or gaining an advantage, without knowing how, through imitating another organization. When facing normative pressure, agents internalise the viewpoints, making them evident instead of subject to choice, i.e., the norms and views will be taken for granted. On this level of institutional influence, the preferences and the cognition of the individual is influenced by the institutions, thus transferring the preferences from an exogenous to an endogenous factor. This implies that institutions not only direct human interaction, but are influential on the very shaping of human preferences. Human interest is not something that is given, but something that is shaped partly by the environment in which the humans are acting; thus rationality is bounded with respect to both extent and direction (Lubatkin, Lane, Collin & Very, forthcoming).

Finally, the concept of legitimacy has to be addressed. A relevant question to ask is why organizations engage in activities aimed at creating legitimacy. The literature is rather ambiguous when describing the driving forces. Our interpretation is that legitimacy is sought because it facilitates exchanges (DiMaggio & Powell, 1983; Zucker, 1987) through identifying the organization as a relevant exchange partner, i.e., a cognitive category (Suchman, 1995; Meyer and Rowan, 1977), and to signal trustworthiness, i.e., an economic category (Zimmerman & Zeitz, 2002).

With these categories in mind, we now turn our attention to predicting the accounting choice of SMCs. Since IT has been construed in order to explain the homogenization of organizations, it is presumably strong in predicting the general tendency.

The coercive mechanism, adherence to norms due to resource dependency, could produce a similarity between SMCs. If there are advantages to being a municipal organization, the organizations have resource incentives to signal that they belong to the set of municipal organizations. As argued earlier, we have indeed found at least one major advantage, which is the shield against bankruptcy which presumably the municipalities offer their corporations. We therefore propose that SMCs, in order to signal belongingness to the family of municipal organizations, tend to use the same accounting standards. This hypothesis is, though, rather weak since it cannot tell us which standard they tend to follow. We therefore turn our attention to other mechanisms.

The mimetic mechanism would predict as a general tendency that all SMCs imitate each other in order to appear legitimate in their organizational field. It does not give any guidelines to an *a priori* identification of the relevant organizational field, but states that the field has to be identified through empirical research (DiMaggio & Powell, 1983). Lacking this contextual information, we are left to speculate. Two grounds for an organizational field can be found: that of industry and that of ownership. We shall return to industry later since industry would presumably produce a variety of accounting choices, and therefore cannot be the ground for a general tendency, but for exceptions from the tendency. The other ground is that of ownership, building on the wisdom of corporate governance, that ownership could be a strong factor influencing the organizational field (Schleifer & Vishny, 1997). In the same manner that we have identified these corporations as similar, giving them one single term—SMCs—so could others. If the focal corporation can be classified as a municipal organization, it will create a feeling of certainty about how these corporations will behave since it will be assumed that they will behave as the stereotyped version of a SMC. A municipal corporation that needs to be treated as a legitimate organization would therefore, together with other signals of municipal organization, choose accounting standards that are typical for SMCs. Hence, the prediction by mimetic mechanism would be the same as for the coercive mechanism, that of similarity, but lacking specification.

The difference between mimetic and coercive must, however, be noted. In the case of mimetic, the argument is cognitive, claiming that organizations in the environment need the signal of accounting choice in order to be able to classify the organization in a municipal category. As for the coercive mechanism, there is no problem for the municipality to interpret and identify the SMC as a municipal organization. Instead, the similarity is caused by the

municipality's demand on the SMC to adhere to municipal norms and the SMCs need to indicate loyalty to the municipality by selecting the accounting principle that is in the interest of the municipality. Thus, in the coercive mechanism, one appears legitimate through submission; while in the mimetic mechanism, one appears legitimate through creating understanding.

The normative mechanism contains both the presence of pressure from professional groups and institutional inertia. The profession in this case is represented by the accountants employed in the various organizations. Accountants in the municipalities put pressure on the accountants in the SMCs to continue to do what they are doing, and have always been doing. The accountants in the SMCs conform to this pressure since they need to show their professional status, made explicit through adherence to the norms of the profession. Thus, there is a pressure, be it conscious or unconscious (Roberts & Greenwood, 1997), towards fulfilling the norms of the profession. This argument would produce the same prediction as the other mechanisms, that of undirected similarity, if it were not for the imprinted or institutionalised argument. *Imprinted* is a norm that has gained an objective presence (Carpenter & Feroz, 2001), i.e., it has become institutionalised. It is not the choice of conducting business-as-usual, but it is a routine that can hardly be subject to discussion since it is 'obvious'. While PAT explains tradition through costs of thinking and social innovation, IT explains it through the cognitive category of institutionalisation, i.e., *taken-for-granted*. In this case, the taken-for-granted could be the historic way of accounting—that of ASB.

Thus, we predict that SMCs will generally tend to make a particular choice of accounting standards because of their need to be legitimate, out of coercive and mimetic reasons, and that the preferred standards will be ASB since it is the ASB standards that have become the institutionalised method of accounting. Thus, the prediction may be summarised as:

HIT1: Swedish municipal corporations will tend to use ASB standards.

As with the PAT predictions, we expect to find exceptions from this general tendency towards use of ASB. One has been indicated earlier, that of industry. The mimetic mechanism demands the existence of an organizational field. Earlier we identified ownership as one possible basis for the organizational field. Another basis is the industry, consisting of the competitors which offer similar products or services to customers (DiMaggio and Powell,

1983; Inchausti, 1997; Mangos & Lewis, 1995). It is rational in two senses to mimic actors that belong to the same field of competitors. First, since competitive advantage can be gained through causal ambiguity between performance and the set of resources and routines, imitation of competitors can produce the same advantage for the imitator. Second, being similar to the other actors in a field gives the organization an appearance of legitimacy. In the case of SMCs, a third reason could be added. In certain industries, such as heat distribution, the corporations have a geographic monopoly, giving them less motivation for imitation for the first reason, that of competitive advantage. But the owners could have an interest in making it possible to compare the monopoly of their municipality with other, similar corporations, typically (in this case) other municipal heat distributing corporations. This tendency to imitate could be further stimulated by industry trade associations. In summary, a mimetic behaviour caused by a need to gain competitive similarity, to create legitimacy, and to create possibilities of comparison induces corporations to behave similarly in the organizational field of an industry.

In addition to this mimetic influence, one must consider the normative influence relative to the factor of industry. Regulatory conventions and codes of behaviour are of vital importance in the Swedish accounting environment. The legislation has the nature of framework legislation, leaving the details and the code of good accounting practice to be developed and maintained by the standard-setting bodies and accounting practitioners, i.e., ultimately by the profession of auditors. The Annual Accounts Act (*Årsredovisningslagen*) from 1995 even prescribed that good accounting practices sometimes can be decided within an industry (*Årsredovisningslagen* 1995/96:10). Accounting choice will be the same within an industry because of the interpretation of good accounting choice made by the profession.

In sum, institutional influences such as mimetic behaviour and, to a certain extent, normative influence will affect the choice of accounting standards. There is, however, no *a priori* method in IT other than through empirical research, that makes it possible to predict a specific set of standards in a specific industry. Thus, we hypothesise that:

HIT2: SMCs belonging to the same industry tend to choose the same accounting standards.

We found in the PAT section of this article that SMCs in the three largest cities of Sweden—Stockholm, Göteborg, and Malmö—would make the same accounting choice. The same

prediction may be made with regard to IT. Being dependent on their owner(s), the SMCs are coerced to use the standards chosen by the municipality, which presumably are the more advanced accounting principles of AC. But IT adds to this explanation the normative factor of the professional group. The large city municipalities have a larger group of professional accountants. These accountants are trained in the advanced methods of accounting and develop a culture of their own, including a specific view of how accounting should be performed. They will tend to promote the use of the advanced methods of AC for two reasons. First, the use of AC would improve the power of the group in the organization since they are the only ones that can implement these standards. Secondly, being a professional group, trained to use these standards, they have internalised them as the 'obvious' standards. These standards are not a matter of choice, since they simply 'are' the standards, i.e., taken-for-granted. The financial accountants' norms are transferred through normative pressure to all organizations where there are individuals who either belong or would like to belong to the larger group of financial accountants (Haka & Chalos, 1990; Mizruchi, & Fein, 1999).

Thus, because of the coercive reason of ownership power and the normative pressure from the professional groups, we expect SMCs of the three largest Swedish cities to tend to use AC.

HIT4: SMCs owned by the three largest cities of Sweden (Stockholm, Göteborg and Malmö) have higher probability of selecting AC standards than corporations owned by other municipalities.

Another factor that would produce the choice of AC is the coercive and normative pressure from The Accounting Council and the profession of auditors. The Council addresses their standard setting towards listed companies and other companies that, due to size, are of general interest. Those companies are expected to apply the standards set by the AC. Large SMCs have therefore a reason to comply with this regulation, since a failure to follow the norm would make the organization appear illegitimate, and would thus make it harder for the SMC to gain resources. But which SMCs are of general interest due to size? The definition of general interest due to size is unclear. The extent to which an organization may be considered large or small depends on the reference point used. If the reference point is the multinational listed Swedish corporations, such as Ericsson and Electrolux, then most of the SMCs would be considered small. But, as argued earlier, it can be expected that the understanding of the

SMCs' organizational field is based on ownership, which makes the relevant comparison point to be other SMCs. We therefore expect to find that larger SMCs will have a higher probability of assuming AC standards than a smaller SMC.

This coercive tendency is reinforced by the professional group of auditors and accountants that support the observance of the regulations since it supports their profession and their extension, and because their professional attitude demands it.

There is, however, a mimetic factor that could reduce the importance of size. Earlier research (e.g., Jönsson, 1985) shows that large companies have a major influence on the development of financial reporting; smaller companies tend to imitate their accounting solutions and the design of their financial reports. This mimetic behaviour could be a way for smaller companies to obtain legitimacy (e.g., DiMaggio and Powell, 1983). However, since applying AC standards implies increased costs compared to applying ASB standards, and because we assume the organizational field in this case to be the municipal organizations, we can assume that there is a trade-off when small corporations agree that benefits of imitating big corporations are considerably less than the costs of the more advanced accounting standards and of signalling separation from the municipal family. It can be concluded that this mimetic behaviour could reduce, but not eliminate, the coercive and normative effect of corporate size. Thus, it can be hypothesised that:

HIT5: SMCs' probability of selecting AC standards will increase with corporate size.

Finally, we end the deduction of hypotheses by a prediction that is original for IT since it is based on the normative mechanism. Auditors and auditing firms are important actors in the process of institutionalising accounting standards (Jönsson, 1985). It can be expected that a professional group will struggle for the right and the opportunity to define the conditions and methods of their work (DiMaggio and Powell, 1983). Auditors influence the conditions of their work through their professional bodies and by being part of the regulatory regime of a country. But they have one more channel of normative influence, which is their work as auditing agents for firms. For example, it has been found that firms audited by one of the big audit firms will disclose more information (Inchausti, 1997). Auditors have a final powerful means to exert pressure, which is to decide whether a firm will receive an auditor's report with or without remarks. They can influence and require their clients to adapt to their

structures and relations. It is, in other words, reasonable to believe that auditors, in their role as professionals, exercise normative pressure regarding companies' choices of the standard-setting body.

Culture and client portfolio may influence the audit habits and competencies of the different auditing firms and their auditors. Over the years, a model of auditing for different customers will be created and diffused in the auditing organization (e.g., DiMaggio and Powell, 1983). An auditor firm, regardless of the overall professionalism of the auditors, tends to create routines that influence the auditors in their work. Simply put, we believe that some auditing firms are more acquainted with SMCs and municipalities, thus promoting the general tendency of municipalities—that is, to choose ASB, while other auditing firms, being more acquainted with the listed corporations, thus promote the choice of AC. We therefore hypothesise that:

HIT6: The auditing firm will influence the SMC's choice of accounting standard.

Summarizing the prediction of the SMC's accounting choice

The predictions that we were able to extract from the two theories are surprisingly similar. The different hypotheses are summarized in Table 1.

Insert Table 1 about here

The two theories, though using different logic, resulted in three identical predictions concerning the general tendency, the influence of industry, and the impact of the three largest Swedish cities as owners of a SMC. Only in the case of SMC size are the theories in opposition. In the two cases of multiple owners and the influence of the auditing firms, only one theory produced a prediction. When two theories only produce one opposing hypothesis out of six, they can hardly be claimed to be competitive theories. PAT and IT are thus to a large extent complementary theories of accounting choice, at least in SMCs. Now we turn to the testing of these sets of hypotheses.

METHOD

Reiterating the aim of this paper, it is to examine the SMC's choice of standard-setting body. A number of factors derived from positive accounting theory and institutional theory are predicted to have an influential effect on an SMC's choice. Since our objective here was to test the influence of the different factors, we collected a sample of SMCs. The Swedish Authority of Municipalities (*Kommunförbundet*) provided us with a list of all municipal corporations. In total there were 1,283 municipal corporations. The data were collected from the SMCs' 2001 annual financial reports and were found in the data file of *Affärsdata*, which is supposed to contain complete information from the financial statements of all limited companies in Sweden.

The dependent variable of Accounting Choice was observed through the annual financial report. Legislation requires corporations to reveal which standards they are using: AC, ASB, or a mix of AC and ASB. However, not every SMC adhered to the legislation. Thus, we created one more class of corporation, those not reporting accounting choice or not being in business. We will return to the sample size later.

The independent variable, Industry, follows the codification given by the data set from *Affärsdata*. This codifying is stated on a five-digit level, but it was possible for this research to use only a one-digit level because of the low frequency of corporations in most categories.

The variable, Single Owner, was given the value of *1* if the corporation was completely owned by a single municipality and *0* if it was owned by several municipalities. The variable is qualitative since the theory predicts a change in probability when more than one owner is present in the ownership structure. It should be noted that there are corporations that are owned by one or several municipalities together with private firms, thus constituting public-private partnerships. These corporations are not considered in the theory and therefore not included in the sample.

The variable, Big City, was given the value of *1* if the corporation was owned by one of the three big cities of Sweden: Stockholm, Göteborg and Malmö. Otherwise it was given the value of *0*.

The variable of Size was measured as turnover in Swedish Kronor (SEK). An alternative to the continuous variable of size would be to use a qualitative measurement. The Accounting Standards Board's classification (BFNAR 2000:2) arranges corporations in three different size categories according to number of employees and net value of the assets. The categorical measurement is not used, however, since theory makes a prediction of continuous influence on the probability of choice. Additionally, number of employees does not reveal societal importance since there are corporations with a large societal impact that have a high turnover but a relatively small number of employees, for example, corporations engaged in electricity production and distribution. Net value of assets could also be difficult to use since corporations owned by municipalities do not have profitability as a main goal and can therefore be expected to have a less precise valuation of their assets.

The variable, Auditing Firm, was observed through inspecting which auditing firm signed the auditing report. Each auditing firm was assigned a value. Due to frequency considerations, only the 'Big Five' firms (Anderson was still in the market in 2001) have been given their own categories, while companies using a firm other than a Big-Five auditing firm have been classified in the same category.

SAMPLE

A total of 1283 municipal corporations were identified. In 134 cases, it was not possible to find data on the choice of standards. Corporations that were inactive, i.e., lacking any current operations, numbered 40. A total of 177 reported only the Annual Accounts Act as their choice of standards but failed to add whether they used ASB, AC, or a mix of both. Corporations are required to report their choice according to regulations of the Accounting Standard Board in Sweden. In our sample of 1243 corporations that had active operations, 311 corporations (25%) failed to report according to the regulations. This indicates a low level of coercive influence and supports the theoretical assertion from the economic notion of opportunism: that legislation and regulation do not predict behaviour. What is needed in order to make a prediction is to include the costs and benefits of adhering to regulations. We can therefore conclude that obedience of the law is not a taken-for-granted matter, but belongs to the accepted set of choices (Watts & Zimmerman, 1990).

The initial sample was 932, which is 73% of all 1243 SMCs with active operations. Table 2 shows the distribution among the different sets of standards. The simple standards of ASB were the preferred set of standards, as hypothesised. But since 18% of the corporations preferred AC, and 21% chose a mix of AC and ASB, the hypothesis is not true for every corporation. Thus, we have reason to continue the investigation.

Insert Table 2 about here

Our derivations of exceptions were focused on the differences that can be found between ASB and AC. This analysis will therefore be based on the sample of 702 corporations that used either ASB (n=506) or AC (n=196). Due to missing data on one or several independent variables, the final sample on which the analysis was conducted comprised 545 corporations. The missing cases represented 22% of all cases. No systematic difference between those selected in the final sample and those with missing values were found when testing for differences in number of employees, assets, and turnover. Thus, it can be assumed that the conclusions drawn from our analysis encompass all SMCs using ASB or AC.

The regression of a qualitative variable represented by a dummy variable such as our variable of accounting choice poses two problems of estimation (Montgomery and Peck, 1982). First, the estimated probabilities can assume meaningless values, specifically values that are negative or greater than one. Second, the errors are not distributed normally. A solution to both problems is to apply a logit model as estimated via a maximum likelihood technique, creating an S-shape curve with asymptotes at 1 and 0 (Kennedy, 1984; Afifi, 1990). The chosen analytical technique is therefore a logistic regression.

ANALYSIS

The descriptive statistics of the variables are presented in Table 3.

Insert Table 3 about here

The dependent variable of Accounting Standard choice shows a significant ($\chi^2=92.9$; $\text{sign}=0.000$) unequal distribution, with a marked preference for ASB. The prediction of a general tendency preferring the simple, less costly, and profit-reducing standards of ASB is supported. There are, however, 29.3% of cases of divergence from the overall PAT hypothesis, which makes it worthwhile to investigate the choices further.

The descriptive statistics of the Industry variable show that almost half of the SMCs are engaged in housing and real estate. The second largest industry is in the technical sector, and the third industry is consulting. In our analysis we will include only these industries, which imply that the constant of the model will carry the influence of the other industries. A majority of the SMCs in the sample (87%) are wholly owned by one municipality. Big City shows that the three big city municipalities of Sweden (Stockholm, Göteborg, and Malmö) have 13% of all SMCs in the sample. Since there are 290 municipalities in Sweden, the three big cities appear to use the corporate form to a considerably larger extent (23.3 corporations on average) than the other 287 municipalities (1.6 corporations on average). This supports our contention about the big cities that they appear to be different in many aspects.

Means of turnover are rather low, but the large standard deviation indicates a skewed sample, which the high kurtosis (76.2) proves. The standard procedure in statistical tests is to use the logarithmic value of turnover. Since the use of the non-transformed variable does not influence the analytical results, and since the value of Beta is easier to interpret, the presented results will be based on an analysis using the non-transformed value of turnover.

The variable of Auditing Firm was created through an analysis of frequency distribution of ASB and AC for the different auditing firms. It was found that PriceWaterhouseCoopers and Deloitte & Touche had a similar distribution (77.8% and 81.8%, respectively) for ASB reports; while KPMG and Ernst & Young (E&Y) had 57.4% and 58.3% for ASB reports. To simplify the presentation, KPMG and Ernst & Young were given the value of 0 for Auditing Firm, and PriceWaterhouseCoopers and Deloitte & Touche were given the value of 1. The statistics indicate that most SMCs in the sample used PriceWaterhouseCoopers or Deloitte & Touche as their auditing firms.

The correlation matrix of the variables in Table 4 presents seven dummy variables, which makes correlation coefficients obscure. Spearman's rho is used since dummy variables have

no normal distribution. Nevertheless, the matrix indicates support for several of our hypotheses. The use of AC is positively correlated with Big City, the auditing firms of KPMG and E&Y and turnover. No Industry effect appears to be present.

Insert Table 4 about here

Table 5 presents the logistic regression equation in which the hypotheses are tested.

Insert Table 5 about here

The model is significant at the 0.001 level and correctly classifies 72.7% of the cases. The improvement of the model compared to the naïve probability of 70.6% is only 2.1%. This is because the model predicts ASB to 95.3% and AC only to the extent of 18.1%. The first impression is that it is not satisfactory to have such a low percentage improvement. It should, however, be noted that the improvement is from a very high starting point (70.6%), that other researchers, such as Neu & Simmons (1996) reported an equally low level of improvement (4%), and that the naïve probability, absent knowledge about the actual distribution, would be random distribution, i.e., 50%. The model is significant, but could indeed be better at finding the AC-cases.

The model could suffer from the problem of multi-collinearity. The correlation-matrix shows low levels of correlations between the independent variables, which indicate absence of a collinearity problem. Running the test with one independent variable excluded did not change the level of significance on the included variables. Thus, multi-collinearity could not cause a problem for the model.

The hypotheses of Big City, Size (turnover) and the Auditing Firm receive strong support. Industry received only weak support. The ownership structure had no significant impact on the choice of accounting standards. We now turn to the interpretation of these results and their consequences for the theory of accounting choice.

SUMMARY AND CONCLUSIONS

The overall results show that SMCs in general apply the less detailed and more conservative standards of ASB rather than the more detailed and less conservative standards of the AC. Several exceptions can, however, be found, such as the strong influence of the auditing firm, the less strong influence of big cities and size, and the very slight influence of industry.

Insert Table 6 about here

Summarizing the outcome of our test (Table 6), we find through simple arithmetic that IT has been more successful than PAT in predicting accounting choice in SMCs. But if we go beyond simple arithmetic and inspect the test and the argument for different hypotheses, we find that a more successful approach towards understanding of accounting choice is the reconciliation of the two ‘contenders’.

The overall tendency was correctly predicted by both theories to be ASB. The PAT explanation is based on the coincidence of interest between owner representatives and the managers, in possible conflict with owner representatives from other parts of the municipality, in addition to the business-as-usual argument, based on costs of thinking and social innovation. IT explanation is similar to the business-as-usual explanation of PAT, since IT too can acknowledge the costs of change. But IT adds a cognitive explanation, that alternatives perhaps cannot even be considered since the normal procedure is taken-for-granted. Consequently, we have found through this hypothesis that we cannot separate the agency choice explanation from the institutional influence since they produced the same significant prediction. What we would like to stress is that the IT conception of institutional inertia (DiMaggio & Powell, 1991), sometimes termed ‘imprinted’, can be dealt with in PAT using costs of thinking and costs of social innovation. The major differences between PAT and IT in this hypothesis are that PAT tends to focus on the conflict between agent and principal, and IT contributes with the cognitive constraint of institutions.

The hypothesis of industry only received weak support. PAT provided only limited support for that prediction, in reference to the signal produced if diverging from the behaviour of competitors. One reason for the prediction failure could be that the theory of signalling is not

applicable to SMCs since they do not have a market to signal to, and that many of these corporations do not have competitors. On the other hand, we have argued in the hypothesis of multiple owners that in the case of several owners, they want strong accounting information, with a desire for the opportunity to make comparisons. In conclusion, we have to admit that we presently do not have sufficient knowledge to explain the prediction failure.

IT had also a weak prediction since it relied on the identification of the organizational field. We could claim that the weak significance for industry and the strong significance for the general tendency shows that ownership is the relevant organizational field. It is, however, not satisfactory to use an *ex post* explanation in order to argue for the *ex ante* prediction since it is tautological. We are here confronted with the IT problem of demanding empirical research before being able to identify the organizational field. It could be argued that it is a matter of abstraction, IT being on a lower level of abstraction than PAT, since PAT does not need contextual information in order to make a prediction. The lower level of abstraction is not a weakness of IT, but constitutes one of its major strengths. The need for empirical data in this case is simply the IT's requirement for contextualisation. An institutional prediction needs the input of context, since institutions are contextually bounded (cf. Neu & Simmons, 1996; Mangos & Lewis, 1995). PAT does not need the information about context since deduction begins after the choice of institutions is made, i.e., institutions are exogenous. Therefore they have to treat preferences and cognition as exogenous. Our conclusion from this hypothesis is that contextualisation could increase the predictive and explanatory power of an accounting theory, but the method of finding the context has to be improved in order to avoid tautological explanations.

The third hypothesis, that one of multiple owners was exclusively a PAT prediction, conveys the basic impression of PAT as focusing on conflicts, and especially those found in the agent–principal relationship, interpreted in a rather narrow way, as in this case, between owners and managers. The prediction failure could be due to operationalisation since our idea is that the decisive point is when one makes the qualitative change from solitary ownership to joint ownership. It could be the case that there is a linear or even a progressive increase of demand on accounting when adding more owners. Our dichotomous variable cannot capture these relationships. Another empirical explanation of the prediction failure could be that multiple owners are as interested in the service outcome of the corporation as the single owner is. Municipal owners, whether in solitude or in multitude, do not devote much attention to

financial accounting numbers, but demand good information about the service delivered, since they, after all, have to deliver a service to the citizens, a service which does not include profit. The main conclusion to be made from this hypothesis is that it shows the PAT preoccupation with the agent–principal relationship and its conflictual nature.

The hypothesis of municipalities owned by the three big cities preferring the more advanced standards of AC turned out to be significant. Since we controlled for size, the supposition that this outcome could be due to their having larger corporations is not well founded. PAT predicted it from the organizational demand for advanced accounting information and the probability of using the competence present in the organization. This is similar to the IT explanation, where it was predicted to be the policy of the owners in order to streamline information. But IT did add the interest of the accounting profession to advance their area of competence, and even the strong normative explanation of taken-for-granted (‘this is the way it is’). Interestingly enough, as with the hypothesis of general tendency, through empirical testing we cannot separate the distinct PAT reasoning of ownership policy and the distinct IT reasoning of the norms of the accounting profession. The two theories should, however, be in agreement on the IT reasoning of the accounting profession that out of group interest, one should choose the norms that create an increasing demand for the group’s services. The only thing that an economist worshipping individual methodology needs in order to accept this part of the IT hypothesis is an elaborated theory of how individual actions can aggregate to group interest. In this case it would not be hard. The accountant has already made the investment of competence, which makes the accountant indifferent to the use of AC or ASB. If promoting AC, the accountant realises that there is a probability that the municipal corporation does not have the accounting competence in the corporation that makes it possible for them to adhere to the owners’ demand. They therefore have to employ an accountant with this knowledge. Thus, promotion of AC will increase the accountant’s employment opportunities. It is a no-cost strategy creating increased opportunities, but as a side-effect increases the field of influence for the class of accountants. Thus, in this specific case, where the choice has no costs involved, collective class-action is possible (cf. Olson, 1968). As a conclusion, we find convincing overlaps between the two theories, though the taken-for-granted part cannot be accepted by PAT.

The hypothesis of the size of the corporation influencing accounting choice is the one hypothesis where the theories evidence competing predictions. Watts & Zimmerman (1990)

claimed that PAT was the only theory that made predictions about firm size and accounting choice. Our theory rejects the claim, and our test shows that PAT is not even good at predicting the choice. The outcome being in significant favour for IT cannot, however, justify a conclusion of the primacy of IT. Part of the prediction of IT emanates from the coercive mechanism, but as we showed in the method section of this paper, municipalities do not appear to be highly sensitive towards coercive pressure from regulators since 25% of the corporations had no problem of not adhering to the regulations of accounting. Obviously, the coercive mechanism is not so coercive.

The major reason for the failure of the PAT prediction would be that the deduction was too occupied with the empirical investigations of political costs. They were conducted in another context, and were therefore limited in their capacity to generalise. In the context of SMCs, we can speculate that the SMC could be willing to assume the political costs of AC, presumably demands on dividends, since the choice of AC could be part of the signalling that the SMC is large, and therefore has a competent manager, capable of managing another large, presumably private corporation, with more advanced incentive systems. Additionally, the large size make the organization a more interesting target for career-minded persons since it offers more positions and greater challenges, thus enlarging the market for managerial labour. The conclusion is similar to the conclusion from our analyses of the first hypothesis that PAT, in order to make a better prediction, is in a need of more contextual information. The failure of the theory is not its reasoning, based on utility-satisfying, but in its negligence of context (cf. Fields, Lys & Vincent, 2001).

The last hypothesis was only deduced by IT, predicting that the corporation's auditing firm could influence the accounting choice. The IT capacity to identify the auditing firm derives from the IT's preoccupation with professional groups. PAT, on the other hand, is preoccupied with the agent-principal axis, which implies that PAT tends to treat auditors as rather obedient vassals of the owners. The significant relationship between the auditing firm and the choice of accounting standard does not, however, support the causality in the hypothesis. There is a significant correlation, but the question remains: Is it the auditing firms that influence the corporation, or is it the corporation that chooses an auditing firm that tends to choose the accounting standard that the corporation wants to select? This question opens again the door for the agency choice of the PAT explanation. The conclusion of our analysis

of the auditing firm hypothesis is that there are overlaps between the theories, and that IT is strong in identifying professional groups.

Summarising our analysis, we have found that the two theories overlap in many instances, that PAT adds the principal–agent focus to the explanation, that IT adds the professional group focus, that PAT would increase its prediction capacity if it included context in the theory, while IT would increase its predictive capacity if it put more emphasis on conflict.

Based on this summary, we have three major conclusions to make about positive theories, of the need to include the context and of the methodology of norms. They can all be summarised in the concluding suggestion of an *Eclectic Accounting Theory*.

Watts & Zimmerman (1979) claimed to present a theory that not only could produce explanations, but also predictions. In contrast to the normal science of accounting at that time, they were not normative. Thus, they included the term ‘Positive’ when baptising their theory in opposition to the dominant normative theories. Times change, however, and today we have many theories that are positive in the negative sense of being ‘not-normative’. The theory presented in this paper and the overall presence of positive versions of IT (DiMaggio & Powell, 1991) represents a rejection of the PAT claim to be the only positive theory. It is absurd that the scientific character of being ‘positive’ is reserved to only one theory in a field. PAT could therefore be re-baptised and given a more descriptive name, such as Economic Consequence Theory (Holthausen & Leftwich, 1983; Meyer, Karim & Gara, 2000). Re-naming can, however, turn out to be difficult to achieve since PAT has acquired the character of a brand. Nevertheless, the brand of PAT has today an erroneous name.

Secondly, there is a need to include the context. We found that IT needed information of the context and that PAT could sharpen its hypothesis if only considering the context more fully. For example, why was not PAT alert on the importance of the auditing firms? One reason could be that PAT is restricted in cognition because of the agent–principal way of thinking. The thinking of PAT tends to organize the world into these two categories, with the result that the agent tends to be recognised as the manager, and the principal as the owner. The presence of accountants and auditors is regarded as one of many partial solutions of the governance problem of separation of ownership and control. This could, to be true, constitute an agency problem of its own, but presumably of much lesser significance than the strong axis of

conflict between the owners and the managers. They are simply comparatively obedient vassals of capitalism. IT declines to accept this attitude. It could be a fact that the auditors started as obedient vassals of the capitalists. But as they rose to become the professional elite of accounting, they acquired a collective interest in furthering their area of influence and to reinforce their traditional area of knowledge. It is hard for PAT, adhering to the methodological individualism, to accept the existence of class action. But the tempered debate about auditors' independence cannot be interpreted as being solely in the interest of the owners, supporting the independence of auditors from being influenced by top management. It could also be interpreted as a struggle of the auditors to be independent from any stakeholder, thus enforcing and reinforcing their societal power.

On the other hand, IT was not successful in identifying the possible conflict in the ownership structure leading to a demand of AC. In this case, the conflict and the groups did fit into the scheme of agent and principal, which made it possible for PAT to identify the possibility of influence upon accounting choice. In this case, the conflictual character of PAT made the theory viable.

The implication for a theory of accounting choice is the need to add context, in this case the context of important or possible stakeholders, and to look for conflicts of interest. Thus, any study of accounting choice need to start with a stakeholder analysis, trying to find, in the context of the corporation, stakeholders that simultaneously have an interest in the accounting choice, and that can influence the accounting choice (Johnson & Scholes, 2002).

Thirdly, we acknowledge that there appear to be a norm in economics to avoid norms. The science of economics has avoided behaviour influenced by norms. A true economic man does not conform to a norm, but chose a norm if the calculation show that the man's utility will increase. There are, however reasons to avoid norms in an explanation. One reason is that they can become an easy-to-find residual explanation. Lacking a good explanation of human behaviour, the easy option is to claim the existence of a norm that guide the behaviour. This laziness of explanation is, however, not a theoretical problem of norms, but a problem of methodology. How do we find out if the norm behaviour is caused by a calculation or if the norm is internalised. After all, we all know that the norm 'you shall not kill your mother' is never subject to a calculation by a healthy individual. Thus, norms constitute therefore less of a theoretical problem of social science, and more a problem of methodology. Empirically we

have found that organizational actors prefer AC in large organizations, but it is hard to determine whether it is because of the accounting professions need to establish themselves as an accounting elite, or if it is because AC is 'obvious', i.e., an internalised norm that is taken-for-granted. What we need is an improvement of the empirical methodology used to separate internalised norm behaviour from strategic choice behaviour.

With these three conclusions we believe that we have shown that there are differences between PAT and IT, but that they can be managed, given the ambition of creating a synthesis of the theories. We showed in our theory section that the theories on the whole are complementary. One example will be given here that indicates that they are not only complementary, but that they can fit into each other.

In our theory section we transformed the assumption of wealth-maximizer into a utility-satisfier because of bounded rationality putting limitations on the individual's capacity to find the optimum. But the individual needs a criterion for the satisfying level in order to be able to make the decision to stop look for more alternatives. Since finding the criterion for the satisfying level involves costs, there has to be a criterion that indicates when the search for the criterion of satisfying level is reached. Thus, the logic of satisficing has created an endless regress of search for criteria. IT offers, however, one possible solution to the endless search for a criterion. Relying on the mimetic mechanism, the individual could decide to assume the competitors criteria. In this sense, the problem caused by the utility-searching individual of PAT is solved with the mimetic mechanism of IT.

We claim that it is no coincidence that IT can support PAT with a solution. Indeed, as our theory section has indicated, it could be claimed that there is a gradual drift from the individual, over the organizations, and ending with institutions. It starts with the individualistic explanation of PAT, as included in the resource-dependency explanations of the coercive and mimetic mechanisms of IT. It continues with the organizational explanations of mimetic and normative mechanisms. Finally, it ends with the cognitive explanations of normative mechanisms where norms are taken-for-granted. This drift could constitute a perspective similar to the constrained-efficiency perspective (Roberts, & Greenwood, 1997). Institutions and the social relations of individuals (Neu & Simmons, 1996) influence the actors' preferences and cognition. Some influence is conscious, and can therefore be subject to choice (Oliver, 1991; Brignall & Modell, 2000), but some are unconscious (Roberts &

Greenwood, 1997), and taken-for-granted. The actors act in a particular situation constituted by the context (Mangos & Lewis, 1995; Puxty, 1997). With this conceptual order we end up with an individual making an accounting choice because it is an effort to satisfy individual utility, or to promote the group the individual is affiliated to, or simply because the individual find the choice evident. And surrounding all this is the notion of bounded rationality, which it is hard to adhere to individual utility, to group norms, and to institutions due to problems of interpretation (Seo & Creed, 2002).

The suggested order of concepts, starting with the normative mechanisms of institutions and ending with the PAT reasoning of the individual, is certainly not a rigid application of the assumptions of human behaviour from one single theory. But we believe that science is not about the scholastic purification of a theory, but to advance the understanding of our realities. We therefore admit that our suggestion is an Eclectic Accounting Theory (EAT). We claim that it has shown some of its potential in explaining accounting choice in our study of Swedish municipal corporations. EAT is a suggestion of productive cease-fire between the opposing theories in order to advance understanding instead of advancing purification.

The road to purification appears, however, to be the primrose path preferred by researchers of today in order to develop our understanding of accounting choice. It could be claimed that PAT has created an industry of conceit (Watts & Zimmerman, 1990; Zimmerman, 2001) and opposition (e.g., Milne 2002, Lukka & Mouritsen, 2002). The dialectics of science could be very fruitful (Holthausen & Leftwich, 1983; Luft & Shields, 2002). But instead of a possible productive dialectics, the industry has created a tribe behaviour of promoting purely internal criticisms (Boland & Gordon, 1992), and variety for the sake of variety (Hopewood, 2002), where researchers are very limited in their literature reviews (Fields, Lys & Vincent, 2001), or with tenacity claiming hegemonic demands of economic reasoning (Zimmerman 2001). In this industry, the tribe behaviour of economists such as Zimmerman are reciprocated by other tribes, those claiming the exclusive right of the truth belonging to their hermeneutic perspective (Chabrak, forthcoming) or the methodological narrow-mindedness of claiming field-based research to be the only efficient method (Ittner & Larcker, 2002) or reducing the importance of statistical testing (Lukka & Mouritsen, 2002), or even the disgraceful condemnation of PAT to be "...virtually rubbish." (Gray, Kouhy & Lavers, 1995, p.70). The industry offers paradisiacal theories that evaluate other theories, especially PAT, paradigmatically, i.e., if PAT conform to the paradise theory ontology (Chabrak,

forthcoming), or producers in the industry engage in promisification, i.e., evaluating another theories results through those results that would have been produced if someone would perform a study according to the lines of the paradise theory (Mangos & Lewis, 1995; Mattessich, 1995 & 2002). Certainly, it is a heated area with a lot of opposition and hard words. We see no advancement of knowledge in their claims or through adding another opposition, but we prefer instead to recommend reconciliation.

We offer EAT, a theory that is basically economic in nature, but includes institutional elements, thus lacking one single basic ontological assumption of human behaviour. This eclectic approach is not a simple solution, but as Hopwood emphasizes, there aren't any simple solutions (2002). We hope that EAT can be a tiny morsel in the satisfaction of the infinite human hunger for understanding. After all, dialectics without the synthesising ambition of an *Aufhebung* will keep us left in the dawn of understanding, but "The owl of Minerva spreads its wings only with the falling of the dusk." (Hegel, [1820] 1967, p.13).

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Table 1. PAT and IT predictions in SMCs

Factor	PAT prediction	IT prediction	Prediction
1. Overall tendency	<i>ASB</i>	<i>ASB</i>	<i>Complementary</i>
2. Industry	<i>Similar standard</i>	<i>Similar standard</i>	<i>Complementary</i>
3. Several owners	<i>AC</i>	<i>No prediction</i>	<i>Complementary</i>
4. Big cities	<i>AC</i>	<i>AC</i>	<i>Complementary</i>
5. Size	<i>ASB</i>	<i>AC</i>	<i>Competitive</i>
6. Auditing firm	<i>No prediction</i>	<i>Similar</i>	<i>Complementary</i>

Table 2. SMC choice of standards

Set of standards	Number	Per cent
ASB	506	54
Mix of ASB and AC	230	25
AC	196	21
Total	932	

Table 3. Descriptive statistics of the variables

Variable		
	Dependent variable	
Accounting Standard	<i>AC (1)</i>	<i>ASB (0)</i>
	160 (29,3%)	385 (70,6%)
	Independent variables	
Industry		
Electricity, gas, heating	141 (26%)	
Housing and real estate	249 (46%)	
Consulting	47 (9%)	
Non-specified industry	108 (20%)	
Single Owner	<i>Yes (1)</i>	<i>No (0)</i>
	472 (87%)	73 (13%)
Big City	<i>Big City (1)</i>	<i>Provins (0)</i>
	70 (13%)	475 (87%)
Size (Turnover)	<i>Mean</i>	<i>Std dev</i>
	0.109512Million SKr	0.283029Million Skr
	≈ 11900Euro	≈ 30700Euro
Auditing Firm	<i>E&Y + KPMG (0)</i>	<i>PriceWaterhouseCoopers + Deloitte (1)</i>
	199 (36%)	346 (64%)

TABLE 4.
Correlation Coefficients for Dependent and Independent Variables (n=545)
(Spearman's rho is presented because all correlations include at least one dummy variable)

	<i>2a.</i>	<i>2b.</i>	<i>2c.</i>	<i>3.</i>	<i>4.</i>	<i>5.</i>	<i>6.</i>
<i>1. Use of AC</i>	-0.03	0.00	-0.06	0.00	0.20**	0.09*	-0.21**
<i>2a. Industry: Electricity etc.</i>	-	-	0.11**	-0.04	0.04	-0.01	
<i>2b. Industry: Housing etc.</i>			-	-0.08	-0.01	0.02	0.03
<i>2c. Industry: Consulting</i>				0.03	0.00	-0.3	-0.4
<i>3. Single Owner</i>					0.06	0.02	-0.3
<i>4. Big City</i>						-0.01	-0.10*
<i>5. Turnover</i>							-0.06
<i>6. Auditing Firm</i>							

†p<.1; *p<.05; **p<.01; ***p<.001

TABLE 5.
Result of logit regression analysis (n=545)

	Probability of AC	Stand Errors
2a. Industry: Electricity etc.	-0.38	0.29
2b. Industry: Housing etc.	-0.29	0.26
2c. Industry: Consulting	-0.87*	0.43
3. Single Owner	-0.11	0.29
4. Big City	0.97**	0.28
5. Turnover	1.56**	0.50
6. Auditing Firm	-0.90***	0.20
Constant	0.62 [†]	0.34
Model chi-square	57.6***	
Per cent correct predicted	72.7	

[†]p<.1; *p<.05; **p<.01; ***p<.001

Table 6. Outcome of the empirical test

Factor	PAT prediction	IT prediction	Prediction
1. Overall tendency	<i>ASB***</i>	<i>ASB***</i>	<i>Complementary</i>
2. Industry	<i>Similar standard*</i>	<i>Similar standard*</i>	<i>Complementary</i>
3. Several owners	<i>AC</i>	<i>No prediction</i>	<i>Complementary</i>
4. Big cities	<i>AC**</i>	<i>AC**</i>	<i>Complementary</i>
5. Size	<i>ASB</i>	<i>AC**</i>	<i>Competitive</i>
6. Auditing firm	<i>No prediction</i>	<i>Similar***</i>	<i>Complementary</i>
Supported predictions	3	5	

**** Strong support, ** Weak support, *Hardly any support*