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Reality and Accounting: The Case for Interpretive Accounting Research

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Abstract

Economic reality plays an important role in accounting practice and standard setting process. Different views exist on the nature of economic reality and how to approach it; while advocates of the positivism paradigm view reality as independently existing, advocates of interpretive paradigm view reality as socially constructed. It is argued in this paper that utilizing interpretive view to the world in accounting research is better able to capture the economic reality that is socially constructed and much affected by our account of it. This is because accounting is a social science and is better understood by gaining the views of different parties involved, which is largely done by utilizing interpretive accounting research.

Keywords: Interpretive Accounting Research, Reality and Accounting, Qualitative Research in Accounting.

Section One: Reality in Accounting

The last five decades have witnessed many attempts by professional bodies around the world, including Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) to issue a conceptual framework for financial reporting. One of the basic qualitative characteristics in such frameworks is reliability. This permits users of accounting information to depend on it with confidence as a true representation (Belkaoui, 2000, p.140). The ingredients of reliability differ relatively across different frameworks. The FASB (1980) framework includes verifiability, neutrality and representational faithfulness. The International Accounting Standards Committee (IASC) issued in 1989 a framework that includes faithful representation, substance over form, neutrality, prudence, and completeness. In 2010, the FASB and IASB, as part of their joint project, issued an update for their conceptual framework, relevance and representational faithfulness became the two fundamental characteristics in the new IASB (Gordon and Gallery, 2012).

Representational faithfulness[1] refers to "the correspondence between accounting data and the events those data are supposed to present. If the measure portrays what it is supposed to present, it is considered to be free of measurement and measure bias" (Belkaoui, 2000, p.140). IASC (1989) argues that for information to be reliable, it must represent faithfully the transactions and other events it either purports to present or could reasonably be expected to represent (para 33).

Aspects of representational faithfulness include substance over form and economic reality. IASC (1989) argues that "If information is to present faithfully the transactions and other events that it purports to present, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form" (para 35). Many accounting bodies have placed much faith in the concept of substance over form (and related economic reality) as an appropriate future direction for the standard setting process (Psaros and Trotman, 2004, p.77). This concept is adopted by IASB in many of its standards (e.g. IAS 31, Financial Reporting of Interests in Joint Ventures and IAS 17, leases).

The economic reality concept has long established roots in accounting practice and research. It has been believed by many practitioners, researchers, and standard setting bodies that accounting can achieve unbiased representation of economic reality. This belief has its roots, Suzuki (2003) states, in traditional epistemic held values inherent in the numerical notation and the form that accounts take. Accounting used to be considered as a non-problematic tool and data source recording a pre-existing economic reality (p.70).

Such views of accounting are embedded within the context of what is called external realism. This, as discussed in the next section of this paper, considers that social reality exists "out there", independently of our account of it, and the social phenomena, such as accounting "facts" exist and are real as objective physical phenomena. Accountants as well as other social scientists, following the success of researchers in the natural sciences, traditionally adopted such a view of the world; according to such a view, an external social reality exists

[1] Related concepts of representational faithfulness are true and fair value and fair presentation: both of them imply representational faithfulness (Alexander and Archer, 2003, p.4).

independently of the representations made of it. The mainstream accounting literature, including standard setting bodies' official publications, tends to focus on measurement problems, suggesting that accountants are dealing with independently existing economic and financial phenomena (Mouck, 2004, p.527). Some accounting researchers have argued for external realism; Solomons (1991) views accountants as journalists, who should report the news and not make it (p.287), and that accounting is like a telephone, which communicates the speaker's thoughts to the listener (p.288). Ingram and Rayburn (1989) consider accounting as a measurement process that depicts reality. They further state that, "whether we define cash payment as an asset or as an expense has no bearing on the empirical phenomenon underlying transaction" (p.67).

The external reality view in accounting has its problems; the expressions economic reality and external realism are ambiguous in a very significant way (Napier, 1993, p.15). One of the major problems is that it deals with accounting objects in the same way as physical objects. The underlying assumption that everything can be reduced to physical phenomena must be rejected (Mattessich, 1991, p.5); many accounting objects such as profit, unlike physical objects[2] are socially constructed, they do not have an independent existence . Their existence is dependent on accounting rules and procedures, such rules are set and filtered by human, thus they are socially constructed objects. The social reality is reflectively constituted by account of reality; socially constructed objects do exist, but not independently of our account of them (Shapiro, 1997, p.168). Applying accounting rules and methods involves subjective factors that shape the picture of economic reality (Suzuki, 2003, p.78). Such constructivist view is largely adopted by the advocates of the interpretive paradigm.

The reminder of this paper is structured as follows: sections two discusses social paradigms in general, section three discuses the use of interpretive paradigm in accounting research, and section four explore the ability of interpretive accounting research in capturing economic reality. Conclusions are set out in section five.

Section Two: Social Paradigms

Research paradigms are a set of basic belief systems. A research paradigm represents a worldview that defines, for its holders, the nature of the world, and the range of possible relationships to that world and its parts (Guba and Lincoln, 1994, p.107). Researchers are required to be clear about their basic beliefs, as paradigms guide the research by directing the modelling as well as through abstracted rules (Kuhn, 1970, p.47). It is believed that the researcher should be clear about his view of the social world, define his or her epistemological stance, and select the appropriate methodological approach consistent with his or her social views and epistemological grounding (Baker and Bettner, 1997, p.306).

Burrell and Morgan (1979) provided a framework for sociological paradigms of organisation theory, containing four mutually exclusive paradigms. This seminal work has a major effect on accounting research, Boland (1989) argues:

[2] The physical objects, such as fixed assets exist independently of us; however, our knowledge of them is socially constructed (Manicas, 1993)

" Their book was an important element in shifting background of assumptions about social sciences that helped to set a stage for more interpretive research in accounting… the result has been an increase in the number of "roles" that are revealed as different perspectives are taken" (p.592).

The first paradigm discussed by Burrell and Morgan is the functionalist; this paradigm has been dominant in the study of organizations. It is rooted on the sociology of regulation and approaches its subject matter from the objectivist point of view. It is based on the tradition of sociological positivism, and in its approaches seeks to provide essentially rational explanations of social affairs (Burrell and Morgan, 1979, p.26). The interpretive paradigm is rooted in the sociology of regulation as well, but through the subjectivist approach to the analysis of the social world. It is concerned with understanding the world as it is. It seeks explanation within the realm of individual consciousness and subjectivity, and within the frame of reference of the participant as opposed to the observer of action (Burrell and Morgan, 1979, p.28). The functionalist and interpretive paradigms are discussed in more detail later in this section.

The radical humanist paradigm is concerned with developing the sociology of radical change from the subjectivist point of view. It has much in common with the interpretive paradigm in terms of the subjective and anti-positivist view. However, it is more concerned with providing a critique of the status quo (Burrell and Morgan, 1979, p.32). The radical structuralist paradigm shares with the radical humanist paradigm its concern with developing the sociology of radical change. However, the radical structuralist paradigm advocates an objectivist standpoint. As the functionalist paradigm is the dominant paradigm in accounting research, and this paper is making the case for the interpretive paradigm, following is a comparison for the two paradigms.

Functionalist Vs Interpretive

Creswell (1994) provided a framework for differentiation of the assumptions underlying both paradigms (see table 1). At the ontological level in the interpretive paradigm, reality is seen as socially constructed; reality is constructed by individuals involved in the research process. Thus, multiple realities exist in any given situation (Creswell, 1994, p.4). In the functionalist paradigm, reality is seen as objective and external to the researcher (Hussey and Hussey, 1997, p.49) and it is singular and out there.

INSERT TABLE 1 ABOUT HERE

In epistemological assumptions, the interpretive paradigm assumes that the investigator and the object of investigation are interactively linked, so that the findings are literally created as the investigation proceeds (Guba and Lincoln, 1994, p.111). The positivistic epistemological stance is that the researcher is independent from what is being researched; the investigator is assumed to be capable of studying the object without influencing it or being influenced by it.

When such influence in either direction is recognized, various strategies are used to eliminate it (Guba and Lincoln, 1994, p.111).

Axiological assumptions are those concerned with values and their role in the research process. Advocators of the interpretive paradigm argue that researchers have their own values, and these values help to determine what are recognized as facts and the interpretations which are drown from them; thus research is value-laden (Hussey and Hussey, 1997, p.49). Functionalist advocates the believe that the research process should be value free; therefore, they consider that they are detached from what they are researching (Hussey and Hussey, 1997, p.49). The rhetorical issue is related to the language of the research, which in interpretive research, should be personal, informal, and based on definitions that evolved during the study. In functionalist research, the language should be formal, impersonal, and based on accepted terms such as relationship and comparison (Creswell, 1994, p.6-7). The above assumptions are related to the methodology, which concerns the entire process of study. In interpretive studies, inductive logic prevails; the emergent themes provide rich context-bound information leading to patterns or theories that explain phenomena. In functionalist studies, researchers use a deductive form of logic, wherein theories and hypotheses are tested in a cause-effect order. The intent of the research is to develop generalizations that contribute to theory (Creswell, 1994, p.7).

Section Three: Interpretive Paradigm in accounting research

Most research in mainstream accounting has been, at least until recently, dominated by the functionalist paradigm (Lukka, 2010, p.112). The functionalist paradigm used to be the natural choice for researcher in the accounting realm, and perhaps it is not an easy task to challenge taken-for-granted assumptions.

This is perhaps largely the reason why accounting research is of a little relevance to accounting practice (Tomkins and Groves, 1983, p. 364). In addition, such domination has led to a restricted range of problems studied and research methods used (Chua, 1986, p.601). The functionalist approaches in accounting research have been widely criticized on many other grounds (Tinker *et al*, 1982; Bettner *et al*, 1994, Kaplan and Ruland, 1991; Tomkins and Groves, 1983; Chua, 1986, Baker and Bettner, 1997, Lukka, 2010).

Functionalist research in accounting and social sciences tends to imitate the methods used in the natural sciences in order to duplicate their success (Bettner *et al*, 1994, p.4). However, this is not necessarily an appropriate approach for a social science such as accounting, which includes studying and understanding social behavior and meanings. The functionalist assumptions, as discussed above, are based on the view that the meanings attached to variables are independent of the situation in which they are used and thus may be approached objectively. However, as argued by Tomkins and Groves (1983, p.366), many of the meanings are situation dependent; thus they need different methods of inquiry. Thus, the assumptions underlying the functionalist paradigm are seen as having an adverse effect on our ability to understand social reality (Baker and Bettner, 1997, p.303).

There has been a continuing call for understanding accounting in the context in which it operates (e.g. Hopwood, 1983: Burchell *et al*, 1980; Roberts and Scapens, 1985;

Damayant, 2013). However, despite the statistical generalizability and rigor issues that distinguish research conducted under the positivistic paradigm, such research tends to ignore the context. This is because the methods employed under this paradigm tend to focus on selected subsets of variables, striping from consideration, through appropriate controls, other variables existing in the context (Guba and Lincoln, 1994, p.105).

Due to the criticisms and shortcomings associated with functionalist assumptions, many accounting researchers advocated the adoption of alternative paradigms in accounting research (e.g. Tomkins and Groves, 1983, Hopper and Powell, 1985, Chua, 1986; Hopper *et al*, 1987; Laughlin, 1995; Baker and Bettner, 1997; Ahrens , 2008; Richardson, 2011). Most notably there was a call for greater use of interpretive accounting research, as interpretive work is concerned with developing our understanding of how people make sense of their world and how their shared meanings affect the way that they interact with each other (Richardson, 2011, p. 72). Subsequently, a considerable body of published work has appeared in accounting periodicals that adopts an interpretive inquiry (e.g. Thomas, 1989; Goddard and Powell, 1994 , Lehman, 1992; Maali and Napier, 2010; Brown, 2010; Bettner and Sowinski, 2013) . Such interpretive inquiry has superiority as having the ability to address the concerns of accounting practitioners and policymakers (Parker, 2012, p. 54)

However, most of this research is in the area of management accounting; in the financial accounting realm, the functionalist paradigm is more dominant. Perhaps the reason for this is that management accounting is more concerned with dealing with processes and functions in organizations, while financial accounting is more concerned with numbers representing financial position and stock price information. This makes rigor and statistical generalizability more important for financial accounting researchers. Despite the dominant functionalist paradigm, the number of researchers utilizing the interpretive paradigm in financial accounting studies is increasing. To mention some of them, Gibbins *et al* (1990) developed a grounded theory on disclosure decisions by firms; Carpenter and Feroz (1992) explain public sector incentives to adopt generally accepted accounting principles; Graves *et al* (1996) studied the visual design of annual reports in the United States; and Maali and Naper (2010) studied the evolution of financial accounting and reporting of Islamic banking through interpretive inquiry.

Section Four: Capturing Economic Reality through interpretive research

Economic reality is a social construct that is affected by many cultural factors. Many accounting researchers (e.g. Hines 1988 and 1991; Morgan 1988; Tinker, 1991; Lukka, 1990 and 2010) have challenged the view of external realism. They argue for a socially constructed accounting presentation, some of them arguing that accounting does not present any reality, rather, it constructs reality. Morgan (1988) argues:

"Accountants often see themselves as engaged in an objective, value-free, technical enterprise, representing reality "as is". But in fact they are subjective "constructors of reality": presenting the situations in limited and one sided ways" (p.477).

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Hines (1988) seems to view all objects, including physical ones, as socially constructed, the master, in her paper says:

"There is a reality: there's something there alright. Do not think for a minute that I am saying we imagine the world! Oh no, not at all! The bricks are there, and the people, and those containers, and the most minute particles in the bricks, and revenue, we create them!" (p. 253).

However, the view of Hines (1988) adopts a more "solipsist position", which, is usually rejected. However, within such constructivist view, there has been debate regarding the nature of reality and how it is constructed. The debate about the nature of "socially constructed reality" still exists. For example, it has been widely accepted that terms such as profit owners' equity have no empirical reference in the "real world" (Lukka, 1990) and they do not appear to denote any objective, external reality (Archer, 1998, p.303). Researchers such as Arthur (1993) questioned what is meant by saying that "profit is socially constructed". He offers three possibilities:

1- All objects are socially constructed, and profit is no different.

2- Profit can only exist in the context of economically active human society.

3- Profit is a social fiction constructed to promote and maintain the interests of particular groups.

Accounting researchers sought help from philosophy. Mattessich (1995 and 2013) developed what he refers to as an "onion model of reality" which considers reality as a hierarchy, consisting of many layers (physical, biological, psychic, and social). Each is characterized by its emergent properties, whereby one layer envelops a lower or more basic layer. Based on this model, accounting objects do exist; a physical reality exists behind the tangible assets and social reality exists behind debts, owners' equity and other accounting objects [3] (Mattessich, 1995, p.49). However, independently of whether something is a physical asset or a social claim, the exchange values (emergent property) of both have social reality status (Mattessich, 2013). Social reality is generated by the interaction of people, which generates social properties, which become facts rooted in territorial and possessive instincts, which in most human societies are sanctioned by legal institutions (Mattessich, 1995, p.56).

A question raised by Alexander and Archer (2003) is whether social reality (including ER) can exist independently of our collective representation. Following Putnam (1981, 1983), the answer is no. Accounting objects, such as income, do not exist independently of our conceptual scheme of representations. This does not mean that accounting objects are not real; rather, they are part of the economic reality that is socially constructed (Alexander and Archer, 2003, p.6). However, Mouck (2004) seems to have a different view; he argues that reality does exist independently. He further argues "We do not create economic reality when we construct reports of economic reality… the economic activity existed before the institution of

[3] Mattessich, (2003) used mortgages as an example of the existence of such reality, he argues: "Try to convince the banker who holds the mortgage on your home that his claim is not real…. Alternatively, how would you react if someone disputed the ownership claim to your property as not real" (p.449)

accounting" (Mouck, 2004, p.533).

The role of accounting in shaping and constructing reality has been investigated by many accounting researchers[4]. Dent (1991) undertook a longitudinal case study of organizational change; he showed how accounting can enter into organizational settings to constitute cultural knowledge, creating particular rationalities for organizational actions, and how this can lead to new patterns of authority and influence. Chua (1995) studied how and why new accounting systems were experimented on within organizations in three Australian hospitals. She explored the social linkages and practices that enabled the accountants "fabricators" to begin the construction of new accounting numbers. Perren and Grant (2000) examine the evolution of control and decision-making processes within four service sector businesses; they argue that employees create management accounting routines. As the business grows, these routines become objectified into localized management accounting "facts". Graves *et al.* (1996) studied the visual design of U.S. annual reports. They argue that pictures and artwork in annual reports serve the rhetorical purpose of arguing the truth claims of those reports and the social constructs they represent. Sinclair (1995) studied the concept of accountability by interviewing fifteen Chief Executives of Australian public sector organizations; she concluded that accountability is subjectively constructed and changes with context. Buhr (2002) provided evidence of how two Canadian companies used environmental reports to "re-shape reality". Furthermore, Maali and Napier (2009) investigated the perceived reality of Islamic banking transactions by banker and the effect of such perception on accounting practice.

Section Five: Conclusions

Studying accounting as a social construct provides a better understanding of the fundamental characteristics of the concepts accounting uses (Lukka, 1990, p.245) and leads to a better understanding of the roles accounting plays. Financial reporting is akin to mapping; it is shaped by political, recreational, religious, economic, technical and other interests (Tinker, 1991; Napier, 1993). Economic reality is part of social reality, which could not be understood in isolation; accounting presents socially constructed reality and in turn participates in creating reality (Hines, 1988; Morgan, 1988; Shapiro, 1997). It is believed, following Alexander and Archer (2003), that objects of accounting are part of an economic reality that is socially (intersubjectively) constructed. Social reality, with economic reality as part of it, exists, but not independently of peoples' beliefs and attitudes (Shapiro, 1997, p.168). The use of traditional research method, that are based on the constructionist view may not be suitable to capture the economic reality. Such methods seek primarily to discover law-like regularities that are testable with empirical data sets—and ignores unique phenomena which are regarded as uninteresting noise (Lukka, 2010, p.112). However, as accounting is a social science is better understood by gaining the views of different parties involved, which is largely done by utilizing interpretive accounting research. as Bisman (2010) put it, "as social scientists, accounting researchers deal with intangible and artefactual phenomena" (p.15), which needs appropriate research that are able to capture the economic reality of different

4 Hines (1989) provides a long list of research in the area of accounting and its role in shaping social reality up to the year 1989.

accounting issues. Interpretive research, which is largely utilize quantitative methods.

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Table 1

Assumption	**Question**	**Functionalist**	**Interpretive**
Ontological Assumption	What is the nature of reality?	Reality is objective and singular, apart from the researcher.	Reality is subjective and multiple, as seen by participants in a study.
Epistemological Assumption	What is the relationship of the researcher to the researched?	Researcher is independent from that being researched.	Researcher interacts with what is being researched.
Axiological Assumption	What is the rule of values?	Value-free and unbiased	Value-laden and biased
Rhetorical Assumption	What is the language of research?	-Formal -Based on a set of definitions -Impersonal voice	-Informal -Evolving decisions -Personal voice
Methodological Assumption	What is the process of research?	-Deductive Process -Cause and effect -Context-free -Generalisation leading to prediction and explanation	-Inductive process -Mutual simultaneous shaping of factors -Context bound -Patterns, theories developed for understanding

Table 1 The Assumptions of the Interpretive and Functionalist Paradigms (Adopted from Creswell, 1994)