

Theories of Financial Accounting: Positive, Behavioral, and Institutional Perspectives.

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ABSTRACT

This paper evaluated leading theoretical perspectives in auditing and international accounting. Specifically, we examined the Positive Accounting Theory (PAT), Behavioral Accounting Theory (BAT), and the Institutional Theory of Accounting. We assessed the individual and collective contributions of positive, behavioral, and institutional theories to the development of financial accounting theory. Notably, we traced the evolution of positive accounting from its earliest mention by Ball and Brown in the 1960s to the extensive research conducted by Watts and Zimmerman. Moreover, this paper assessed the intricate relationship between normative and positive accounting in both theory and professional practice. In summary, the development of positive, behavioral, and institutional approaches to accounting helped broaden the scope of financial accounting research and practice.

Keywords: Accounting Theory; Behavioral; Financial Reporting; Institutional; Positive Theory; Normative Theory.

INTRODUCTION

The history and development of accounting theories have followed patterns similar to those of most social sciences. This evolution has progressed from one dominant view to another. For example, normative accounting was once in vogue and used prescriptively to explain accounting transactions. Over time, accounting scholars abandoned prescriptive normative theory in favor of positive theory. In their view, accounting theory should explain day-to-day practice rather than prescribe what to do. In particular, positive theory emerged from positive economics, which gained popularity through Milton Friedman's (1953) work. Positive theory first entered accounting research in the 1960s (Watts & Zimmerman, 1986). According to Ball & Brown (1968) and Beaver (1968), positive theory first appeared in accounting research as a repudiation of normative narrative. Like positive accounting, behavioral accounting is multidisciplinary, with roots in sociology, decision sciences, and psychology. Similarly, institutional accounting theory grew out of sociological studies. Thus, accounting theory has drawn heavily from other social science disciplines for its theoretical and conceptual growth.

Given this background, this paper will explore the historical and contextual development of positive, behavioral, and institutional accounting theories. It will also examine and summarize the core ideas of each theory to show their relevance to how organizations use internal accounting controls to steer the organization toward sound financial results and reporting. We will compare and contrast the theories to deepen our understanding. Finally, we will evaluate whether strong internal accounting controls lead to overall organizational success or failure. This paper will also review historical and contemporary studies to expand our understanding of the core concepts discussed.

Accounting Theory

Accounting theorists and practitioners often draw a line between theory and practice. In reality, accounting theory underpins professional practice. Theory is abstract, a mental construct, and contrasts with real-life activity

(Kam, 1990). Theory implies a rationale or explanation for a specific subject matter. Watts & Zimmerman support this, noting that “the objective of accounting theory is to explain and predict accounting practice” (1986, p. 2). The authors suggested that what should be predicted and defined as explanation is giving meaning to observed practice, such as the theory behind two inventory practices: last-in, first-out (LIFO) and first-in, first-out (FIFO). Watts and Zimmerman further implied that prediction, as used in accounting, means using theory to explain conventional accounting norms. They suggested that unobserved phenomena relate to accounting events that are yet to be systematically evidenced. Meanwhile, the authors noted that such predictions are mostly tested with historical data collected from companies operating under each of the two inventory systems (Watts & Zimmerman, 1986, p. 2).

Watts and Zimmerman (1986) discussed two inventory concepts, LIFO and FIFO, as alternatives in financial reporting. They argued that accounting choices affect decision outcomes, and individuals often select methods to boost their well-being while considering consequences for their organization. For example, organizations choosing depreciation methods weigh pros and cons, with managers focusing on stock and bond prices. Historically, accounting decisions influence stock performance, and managers seek understanding of these effects (Watts & Zimmerman, 1986, p. 3).

In other words, when accounting researchers speak of fund theory, depreciation theory, and so on, they refer to an all-inclusive system of theorems and postulates. As Kam (1990) notes, a deductive system represents the most advanced type of theory.

Kam (1990) argued that accounting theory has not yet reached the stage of using logical derivation. This means that accounting has yet to demonstrate that a particular accounting method is derived from a specific accounting principle. For this reason, the accounting discipline, through the FASB, often uses a conceptual framework in place of theory. Similarly, Watts & Zimmerman (1986, ix) concluded that “complexity and change ensure that we will never have a complete theory of accounting”. Watts and Zimmerman’s (1986) comment on accounting theory supports Kam’s (1990) view. Accordingly, they added that theory does not provide rules for choosing among competing accounting procedures. Instead, it interprets the practice of accounting and auditing (Watts & Zimmerman, 1986). It is not enough to observe the interconnections among accounting variables. Theory is needed to explain every observed significant and non-significant association between or among variables that affect accounting transactions.

Accounting researchers develop and evaluate hypotheses to confirm or refute theories. When a hypothesis produces significant results, it supports the theory as an explanation for the study’s findings. Sometimes, collected evidence prompts revisions to the theory, reformulation of hypotheses, and further testing. This indicates that theories evolve in response to factors that prompt updates (Watts & Zimmerman, 1986). Watts and Zimmerman’s positive accounting theory contrasts with the initial view of accounting based on practice and practitioners. Their theory does not prescribe specific accounting methods. Instead, it explains why certain practices are adopted and which organizations might choose particular valuation methods, without proposing a specific practice itself (Watts & Zimmerman, 1986, p. 7).

Watts and Zimmerman (1986) concluded that the emergence of positive accounting theory would position the accounting discipline to become influential within economics and finance research (p. 358). Sterling (1990, pp. 121–122) argued that if the propositions of Watts and Zimmerman (1986) are accurate in claiming that positive accounting theory is positioned within the mainstream of finance and economics, it follows that applying positive economic theory to national income accounting should result in (a) a redefinition of the theory behind national income accounting; (b) research explaining why and how national income accountants work for their individual preferences when choosing a method for accounting for national income; (c) condemnation of scholars such as Kuznets, Stone, Meade, & Ruggles, and others who are pro-normative accounting, for not being scientific enough in their methodologies that prescribe a certain method of national income accounting; (d) charges that Kuznets, Stone, Meade, & Ruggles were more interested in reacting to pressure from market forces than in providing an explanation that rationalizes national income accounting practices that formed the focus of their study (Sterling, 1990, pp. 121–122).

Given this, we can agree that accounting theory is still evolving. Going forward, Kam (1990) articulated and summarized what he considered to be the attributes of the postulates and assumptions of an accounting theory. His compilation produced the following:

- a. Entity. Kam suggests that accounting and related functions occur within the firm's environment.
- b. Monetary unit. Kam implies here that money is the common unit for accounting transactions and measurement.
- c. Exchange prices. This means decision-making relies heavily on past, present, and future price trends in exchange markets.
- d. Continuity. The basic assumption of accounting theory is continuity. The impression is that corporations, once incorporated, are eternal; the opposite is true.
- e. Time period. Accounting transactions occur and are recorded over time. For example, US firms listed on various exchanges report their financial statements for January through December, with quarterly reports in between (Kam, 1990, pp. 46-47).

Contemporary accounting theory has expanded the basic assumptions or postulates of what constitutes an accounting principle. Kam (1990) and Hermanson, Edwards, & Maher (1992) also summarized a number of standards applied commonly by accounting researchers and professionals:

- a. Historical cost measurement. This represents the amount paid to obtain or use an asset.
- b. Revenue recognition. This principle relates to earning or realizing revenue before recording it as income.
- c. Matching principle. This accounting principle matches income earned in a period with the expenses incurred in the same period. This means matching sacrifices made with the benefits reaped within the same time period.
- d. Disclosure requirement refers to the obligation of organizations to report key information that could influence stakeholders' interpretation of the accounting data.
- e. Gain or loss recognition. In simple terms, this principle requires companies to record gains when they are realized and acknowledge losses as soon as they are detected. Consequently, companies might record losses before recording gains.
- f. Expense recognition. This means firms record expenses as they are incurred. This requirement is closely related to the revenue recognition principle (Kam, 1990, p. 47; Hermanson, Edwards, & Maher, 1992, pp. 561-568).

Watts and Zimmerman (1986) traced accounting theory to economic and financial changes. They highlighted Joel Dean (1951) and Modigliani and Miller (1958) for using economic tools to solve financial issues. Early attempts to theorize and develop methodology faced rejection, but later gained acceptance. These initial studies tested existing theories and connections between accounting and economics, as well as the validity of accounting figures. However, they did not explain accounting practice. Watts and Zimmerman criticized this focus on testing past theories rather than explaining practice, applying the same logic to finance research and traditional financial views.

Early accounting theory debates focused on government regulation of financial disclosures. Most research criticized regulation, leading to a shift toward an economic theory of accounting, as seen in finance literature and regulation theories that explore accounting and auditing practices (Watts & Zimmerman, 1986). The diagram below illustrates the financial accounting environment and how it reflects accounting theory and practice.

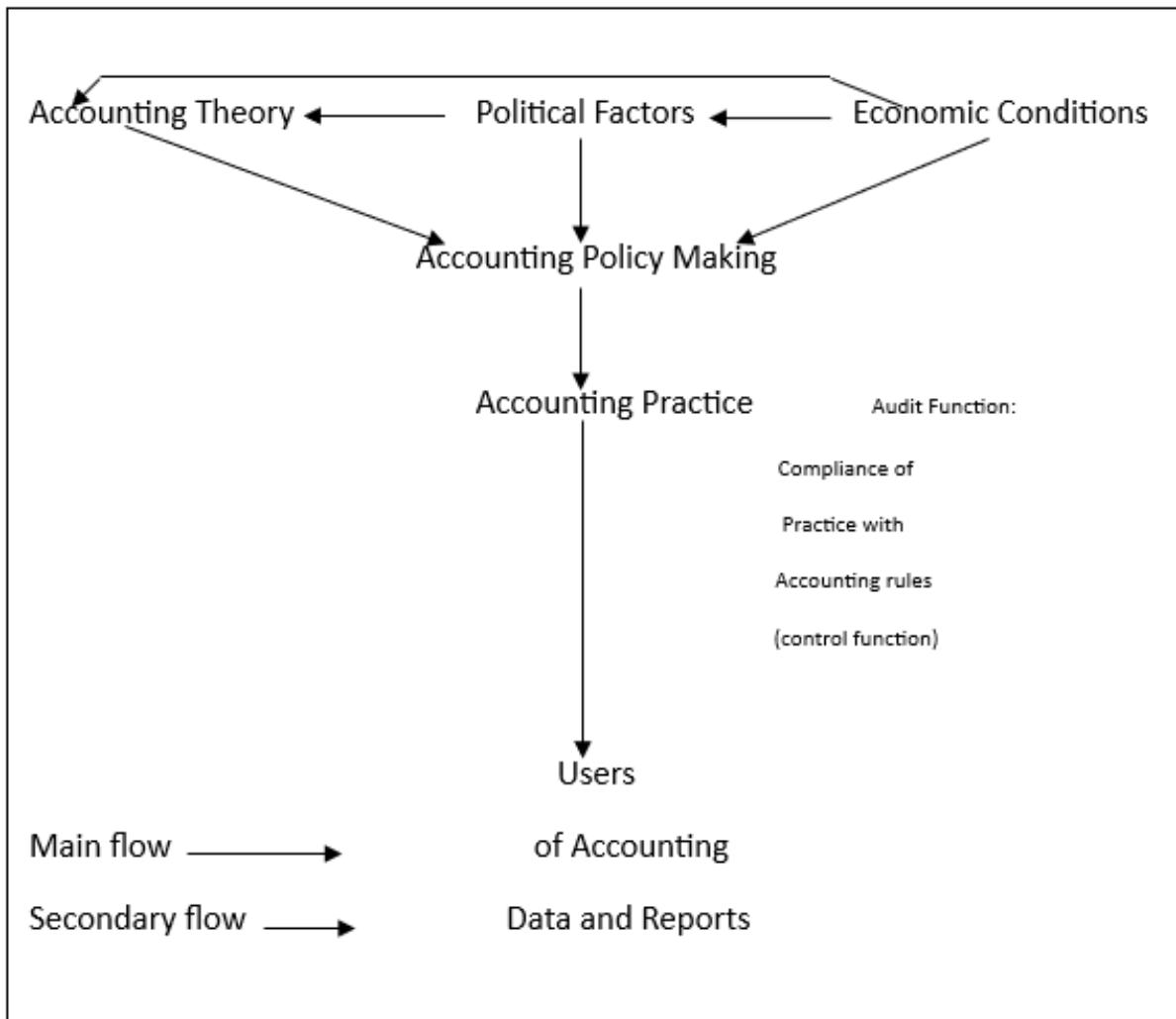


Figure 1: Diagram of the financial accounting environment. Source: Wolk, Tearney, & Dodd, 2001, p. 5

Approaches to accounting theory and research

Having examined the origins and development of accounting theory, the next task is to examine the approaches to accounting theory. As stated earlier in the paper, accounting theory derived its autonomy from several fields of study. The approaches examined here are those articulated by Wolk, Tearney, & Dodd (2001). According to the authors, these approaches indicate the orientation, or current trend, in accounting research: a fundamental shift from normative to positive accounting theories. The following approaches are identified for brief discussion:

Decision-Model approach.

This approach views accounting as primarily providing decision-making information (Kam, 1990, p. 49). It emphasizes supplying data for specific decisions but doesn't focus on users' overall needs. Critics challenge its normative basis; Wolk, Tearney, & Dodd (2001) argue that its normative nature makes it non-scientific, leading some to reject it in favor of newer theories.

Capital markets research.

This model derives from the finance proposition known as the efficient markets' hypothesis. The model relies on the large volume of information released daily through financial market transactions. Thus, markets react to

this daily release of pertinent information in stock trading. Wolk, Tearney, & Dodd believed the efficient markets hypothesis has major implications for accounting practice (2001, p. 43).

Behavioral research.

This approach emphasizes how accounting information users make decisions and the specific information they require. It primarily employs the descriptive method and is part of positive theory, in contrast to the normative decision-model approach (Wolk, Tearney, & Dodd, 2001). The authors noted that this approach is still developing, though it has made moderate progress and produced promising results.

Agency theory.

This theory is also known as the contracting theory. The agency perspective gained currency in accounting discourse through the work of Watts and Zimmerman (1986). It originated in finance and economics. The theory assumes that individuals act to best protect their interests, which may conflict with organizational interests (Wolk, Tearney, & Dodd, 1986). Another assumption places the organization at the center of most contractual arrangements among major actors, such as business owners, the government, management, and creditors (Wolk, Tearney, & Dodd, 1986). In effect, agency theory addresses the costs of regulating and enforcing contractual relationships among the entities listed above (Wolk, Tearney, & Dodd, 1986).

Information economics.

Growing awareness of the cost-benefit implications of producing accounting information led to the emergence of a new research area called information economics (Wolk, Tearney, & Dodd, 2001). Information economics sometimes uses agency theory assumptions in its analysis. Its methodology follows the analytical-deductive matrix. This approach primarily focuses on achieving a meeting of minds in a contractual relationship, balancing risk sharing and reward distribution. This approach highlights the primacy of stewardship in accounting practice (Wolk, Tearney, & Dodd, 1986).

Critical accounting.

This approach results from the fusion of social accounting and public interest accounting (Wolk, Tearney, & Dodd, 1986). However, critical accounting appears to be larger than anticipated, with mergers. The leading theorist hoped to advance the approach by adopting a conflict-inclined viewpoint. The point of departure between critical accounting and the other approaches discussed above is that they examine accounting problems based on reality, and as they examine and resolve these problems, they invariably shape those accounting realities (Wolk, Tearney, & Dodd, 1986).

Having traced the origin and development of accounting theory, I would add that accounting researchers, public accounting firms, organizational accounting policy-making processes, and the private sector began and refined it. In the next section, we will examine positive accounting theory.

Positive Accounting Theory

Positive accounting theory first appeared in the 1960s when Ball and Brown (1968) included accounting research in stock markets and choices. The Rochester School supported developing positive theory and criticized normative theory as unscientific (Christenson, 1983). They borrowed the idea from Milton Friedman, arguing that predictions help test theories (Christenson, 1983). Watts and Zimmerman (1977) also viewed normative theory as unscientific, focusing on prescriptions rather than theory development and driven by users' needs for accounting reports (Watts & Zimmerman, 1986, p. 9). Normative theory debates what should be (Kam, 1990, p. 490) and requires a clear objective. Watts and Zimmerman, dissatisfied with normative theory, called for a positive theory to challenge it (1978). Kabir (2010) noted that positive theory marked a significant departure from normative approaches.

From the above, efforts appear to have established positive accounting theory as a legitimate and scientific theory of accounting that affirms the positivist orientation of accounting research and practice. Sterling (1990) suggested that “one function of a theory of a discipline is to provide guidelines to the practitioners of that discipline, and practitioners are sometimes studied to see if they are properly following the dictates of the appropriate theory” (p. 116). Building on their conceptualization of positive theory, Watts and Zimmerman extolled the importance of positive accounting theory, noting its utility in providing responsible parties with predictions, explanations, and outcomes of their decisions (1986, p. 14).

Wolk, Tearney, & Dodd (2001) offered a different perspective on positive accounting theory. Accordingly, the authors argued that positive accounting research reveals previously unseen behavioral relationships in accounting. While the authors attempted to define “what is” without value judgment, they must, however, make a value judgment (Wolk, Tearney, & Dodd, 2001, p. 33).

Wolk, Tearney, & Dodd, regrettably, also critique the behavioral explanation of their positive accounting theory. In their reply to Watts and Zimmerman’s analysis of how firm management might react to the FASB’s proposed standards, they noted that empirical research on human behavior can be interpreted in multiple ways. They advised caution in framing such empiricism, aligning it with existing research standards (Wolk, Tearney, & Dodd, 2001, p. 34).

Accounting research scholars use positive accounting theory to describe issues. Milne (2002) noted Watts and Zimmerman’s focus on three predictors: lobbying, behavior, and accounting method, based on departmental heads’ precepts. This theory explains why most organizations make voluntary disclosures, aligning with Watts and Zimmerman’s focus on accounting choice behavior (1986). They highlighted three key indicators: debt contracts, compensation plans, and political costs (1986, p. 246). Over ten years, Watts and Zimmerman observed that research often uses variables such as incentives from bonus plans, debt contracts, and political costs. They found that bonus plans are most common because they tend to improve current reported income (Watts & Zimmerman, 1990, p. 138).

The authors, however, argued that these indicators are not mutually reinforcing but instead reflect conflicting incentive plans and trade-offs that organizations intentionally use for earnings management (Watts & Zimmerman, 1986, p. 246). In addition, organizational heads have discretion over which accounting procedures, or combinations of procedures, the accounting entities adopt. These choices are not limited to a single procedure, such as selecting an inventory method for quarterly and annual accounting reports (Milne, 2002).

Watts and Zimmerman’s theory outlines indicators of accounting procedures (Milne, 2002, p. 377). They agreed that empirical evidence shows accounting choices vary with factors linked to political and contracting costs (Watts & Zimmerman, 1986, p. 243). They argued that political and contracting incentives influence accounting procedure choices and predict opposing effects on stock prices from changes in accounting practices (p. 243). Changes that boost revenue are expected to raise share prices due to reduced default risk, whereas others could lower share prices (Watts & Zimmerman, 1986, p. 243). While research incorporated candidates for political costs, Milne (2002) warned that some empirical studies’ political-cost variables weaken Watts and Zimmerman’s original goals. Milne explained that current income affects accounting choices, especially among large-scale profit takers (p. 378). Watts and Zimmerman (1990) also highlighted the importance of the information perspective in global market accounting.

Critically, Watts and Zimmerman observed that the information viewpoint did not provide hypotheses to predict and explain the selection of accounting procedures, except for inventory methods. They criticized the information viewpoint for its inability to generate hypotheses that could predict and explain why a firm would alter its inventory or depreciation methods (1990, p. 132). However, Watts and Zimmerman (1990) offered valuable insights into the reasons for the information viewpoint’s failure to propose hypotheses capable of predicting and justifying accounting choices. Specifically, they noted that the propositions of finance theory underpinning the selection of accounting procedures do not influence firm value; therefore, they are incapable of predicting or explaining accounting decisions (Watts & Zimmerman, 1990, p. 132).

Watts and Zimmerman (1990) argued that most research on accounting choices focused on individual choices rather than an aggregate of methods. They warned against substituting accrual methods for simplified measures based on assumed lack of management control. They also critiqued initial bonus hypothesis tests for oversimplification. Additionally, they predicted that higher debt/equity ratios would lead managers to adopt procedures that inflate reported revenue, and that larger firms would prefer accounting methods that reduce profits under the political cost hypothesis, because the costs of informing the public about monopolistic profits outweigh the costs of influencing legislation.

Summarizing the political cost hypothesis, Watts and Zimmerman (1986, p. 242) noted that the economic perspective on political cost frames it as a struggle to transfer wealth. They argue that the combination of information and lobbying significantly increases political costs (Watts & Zimmerman, 1986, p. 242). Furthermore, the authors assert that accounting figures are used in politics and regulation to signal potential crises (Watts & Zimmerman, 1986, p. 242).

Behavioral Accounting Theory

Behavioral accounting emerged in the 1960s, grounded in the behavioral sciences (Birnberg & Shields, 1989; Burgstahler & Sundem, 1989; Caplan, 1989; Lord, 1989). Early research sought to explain the relevance of behavioral issues to accounting theory and practice, gaining traction quickly while establishing standards for empirical research (Caplan, 1989). Belkaoui (1989) described it as examining how accounting information influences decision-making and improves organizational performance. Caplan noted that behavioral accounting shares goals with organizational theory and involves understanding decision-making behaviors resulting from information communication. The American Accounting Association emphasized understanding, explaining, and predicting human behavior through peer-reviewed, replicable empirical generalizations (Belkaoui, 1989).

The American Accounting Association envisions a behavioral science capable of predicting and explaining human behavior from an accounting perspective. Accounting practice and research are embedded in behavioral science and shaped by the actions of management accountants, who create and package accounting information for the annual financial statements (Belkaoui, 2002). Behavioral accounting research (BAR) explores how human behavior affects accounting information and issues. Birnberg and Shields (1989) described BAR as a think tank within accounting research. They highlighted that BAR differs from other types of accounting research in its goals, assumptions, and focus. According to Birnberg and Shields, BAR researchers' underlying assumptions, methodologies, and emphasis on ongoing problems distinguish it from other research approaches in accounting (pp. 23-24).

Lord (1989) noted that BAR integrates multiple disciplines and draws on theoretical models from the behavioral sciences. A major influence on behavioral accounting was Carl Devine (1960), who examined how psychological factors shape consumers' responses to accounting information. In a well-known passage, Devine urged attention to all individuals affected by accounting decisions, especially the psychological reactions of report users. He noted that many accounting transactions occur within a complex web of human psychology and warned that ignoring human behavior in accounting theory could be disastrous. Nevertheless, he also observed that this presumed link between human behavior and accounting theory has limited support in existing academic research (Devine, 1963, p. 394).

Human decision-making is inherently complex and often shrouded in ambiguity. This is especially true in accounting decisions, which are affected by procedural uncertainties. Srivastava and Mock (2000, p. 24) recognize this, noting that "ambiguity and uncertainty are common in behavioral auditing and accounting research." Such complexity underscores the importance of examining how behavioral factors influence accounting research. Birnberg (2000) points out that a significant challenge in complex organizations is the lack of effective monitoring methods. Consequently, he suggests that behavioral models could offer valuable assistance in navigating complex, ambiguous issues in accounting research. Maines (1994) adds that the sociology and psychology literature provides insights into how individuals and groups use and are affected by accounting information, which in turn shapes their rationality. Since the 1970s, considerable progress has been made in this field. Caplan (1989) summarized these contributions into broad categories.

Financial Accounting

1. Summarizes how managers and accounting professionals react behaviorally when preparing and presenting accounting information.
2. Character traits of the end users of accounting information.

Managerial Accounting

1. Variables in individual behavior.
2. Issues relating to the organization.

Auditing

1. Individual character traits of persons within the audit unit.
2. Judgment calls by the auditors.

1. Human Capital Accounting
2. Socially Responsible Accounting
3. Accounting for Information Systems and Human Information Processing (1989, pp.112-113).

From a different perspective, Hofstede and Kinard (1970) noted the absence of a unified research perspective on behavioral accounting. The authors argued that a literature review alone cannot adequately answer the question, “what is behavioral research in accounting” (Hofstede & Kinard, 1970, p. 41). To this end, the authors added that accounting numbers represent cause-and-effect aspects of human behavior, while denouncing accountants for having the potential to fashion a financial system or method that will influence human behavior in a desired direction (Hofstede & Kinard, 1970, p. 38). The authors questioned the propriety of accountants conducting research on human behavior (Hofstede & Kinard, 1970). This disdain for the behavioral content of accounting research had two consequences. As Hofstede and Kinard noted, the first was a notion of “no accounting.” The other relates to the unethical nature of manipulating human behavior. The authors debunked these claims as untenable and presented financial information as the basis for users' preferences. It simply suggested that accounting information is meant to be used by stakeholders for decision-making purposes (Hofstede & Kinard, 1970, p. 39).

Hofstede and Kinard defined BAR as the study of the typical behavioral traits of accountants. They also linked it to how non-accountants' behavior affects accounting activities and reports. Furthermore, they stated that BAR influences research across the fields of financial, managerial, and tax accounting (Hofstede & Kinard, 1970, p. 43). The authors identified three reference points that could be relevant to accounting research on human behavior.

- a. An assessment of the influence of individual accountants and collectivities on the work they perform;
- b. How does the behavior of accountants square up with their decision-making abilities relative to the accounting principle of materiality; and
- c. How much influence does accounting information bear on the behavior of its users (Hofstede & Kinard, 1970, p. 43).

Divine (1960) highlighted efforts to describe and compile individual and group responses across business contexts. He noted that researchers have sought to identify behavioral patterns for estimation, grouping, and testing against established business models (Divine, 1960). Divine argued that constructing business models in the social sciences resembles theory development, involving concept definitions that yield behavioral predictions through logical and mathematical methods (Divine, 1960, p. 395). He also claimed that accounting theory can be conceptualized independently, with research boundaries clearly defined, without requiring expertise in psychology or implying that behavioral accounting derives from psychology (Divine, 1960). Similarly, Mattessich (1957) proposed a system grounded in deductive reasoning, emphasizing the advantages of a deductive approach to accounting systems.

- a. It introduces the ability to generalize or even expand existing models in accounting.
- b. It introduces clarity into accounting structure and promotes the idea that accounting transactions are based on reality and not otherwise.
- c. It introduces new accounting horizons. It borrowed heavily from the language of mathematics to explain the often-vague terminology of traditional accountants.
- d. It opened the door to the art of ordering, axioms, and theorizing in accounting.
- e. It promotes the exchange of accounting terms and concepts across all accounting fields (Mattessich, 1957, pp. 329-330).

Mattessich made several efforts to define concepts and build theorems by applying relevant aspects of logical calculus, which were later used to validate vital structural accounting propositions. Devine (1960) argued for the continuous examination of the overall process of accounting research and practice using prevailing tools of investigation in the field. He questioned the continued neglect of historical and other advanced fields of study and called such neglect 'squandering of intellectual resources' (Devine, 1960, p. 394). He commended progress in using statistical theories for theory verification, but noted that much more work is needed on evidence and proof (Devine, 1960, p. 394).

He agreed that accounting shares similar problems with other scientific disciplines, except in procedure. In particular, Devine noted that the accounting concept of materiality is similar to significance in statistics and psychology (p. 394). To identify aspects of human behavior that affect the daily decisions accountants make and how they impact accounting research, Devine (1960) articulated the following questions, whose answers define the line and interactions between accounting and other scientific disciplines:

- a. How do we determine the accounting transactions that will be recorded and reported and otherwise?
- b. How far would potential fraudsters be discouraged by fear of being seen to be colluding?
- c. What are employee reactions to standard measures compared to ordinary standards?
- d. What degree of influence do owners experience from income reports relative to investments, withdrawals, and labor relations?
- e. What are normal responses to cash and liquidity statements, markup, and turnover rates?
- f. To what extent would merchants agree to swap control, stable management, and honor for a steady increase in profit?
- g. Do the internal control systems influence the accuracy of recordings and accounting reports?
- h. How do we determine the limits of what the entity can do? (Devine, 1960, p. 394).

It is hoped that responses to these questions will clearly demonstrate the importance of behavioral science for accounting research and practice. Belkaoui (2002) noted that managing processes over a specific period requires clinical judgment to approve or reject variance analyses comparing standard and actual results (p. 209). Furthermore, management must choose appropriate actions to minimize or correct issues caused by attempts to manipulate or distort accounting data used in both internal and external decision-making. Often, adjusting accounting data is a strategy to limit damage in budget control and to boost revenue (Belkaoui, 2002).

Institutional Accounting Theory

Accounting theorists frequently employ institutional theory to understand changes in management accounting. One of the earliest references to this approach is Burns and Scapens (2000), who identified three popular social science theories: new institutional economics (focused on transaction costs), old institutional economics, and new institutional sociology (Burns & Scapens, 2000, p. 4). Although these theories have different origins and backgrounds, Burns and Scapens (2000) highlighted that they all share an interest in institutions and institutional change, offering modest insights into management accounting evolution. Institutional theory underscores the connection between cultural values, belief systems, and the organizations operating within this social context.

Over time, these perspectives become institutionalized, “reflecting the widely shared constructions of reality and tending to be taken for granted as legitimate” (Wanderley, Miranda, Meira, & Cullen, 2011, p. 112). From an institutional perspective, management accounting concerns the existing organizational rules and norms that guide the entity's activities and operations (Wanderley et al., 2011). Burns and Scapens (2000) echoed this, noting that their institutional framework accepts that management accounting activities both influence and are influenced by the same institutions that guide the entity's operations.

Sellers, Fogarty, & Parker (2012) described institutional theory as a framework for explaining organizational actions within organizational fields in societies, emphasizing legitimacy. Organizations seek legitimacy through ceremonies and mythologies to foster followership. The theory helps distinguish permissible from impermissible behaviors. Kamoche and Harvey (2006) identified threats, such as organizations adopting non-preferred behaviors due to lack of knowledge or misconceptions, which can hinder applying institutional theory to complex issues. DiMaggio (1988) and Suchman (1995) noted that rules and regulations can promote legitimacy and stability by reinforcing organizational norms.

Organizations operate within an institutionalized, hierarchical environment that requires leadership structures to meet public expectations (Sellers, Fogarty, & Parker, 2012). These structures can support or undermine organizational interests. Institutional theory explains how organizations gain external social sanction and leverage internal activities (Sellers, Fogarty, & Parker, 2012). Scott (2008) described institutional theory as the beliefs, attitudes, and behaviors shaped by interactions, both organizational and interpersonal.

Levels of Isomorphic pressures

Early research on institutional theory described three processes that can initiate institutional change. For example, DiMaggio & Powell (1983) proposed the normative, coercive, and mimetic pressures (p. 150).

Coercive

The coercive mechanism stems from intense political influences and issues that border on the legitimacy of institutionalized organizational structures (DiMaggio & Powell, 1983). Coercive isomorphism can arise from unofficial or official sources and reflects forces directed at the organization by other entities it depends on, as well as pressures from the organization's operational environment (DiMaggio & Powell, 1983). Studies by Teo, Wei, & Benbasa (2003) suggest that organizational pressures can emanate from holding companies, regulatory bodies, customers, or even suppliers. Competition and regulation are the main dimensions of coercive pressures found in institutionalized organizations (Pi-Tzong, Hsi-Peng, & Tzu-Chaun, 2012).

Mimetic

Mimetic isomorphism describes how organizations imitate others during periods of uncertainty, leading to modeling. DiMaggio & Powell (1983) state that modeling is an organizational response to uncertainty. Sometimes, the organizations being modeled are unaware. Innovations, such as the Samsung Galaxy S11, result from modeling, as with Taiwan copying Japanese tech or China mimicking American tech. Organizations tend to copy successful, established firms.

Normative

The second isomorphic mechanism is normative and linked to professionalization. DiMaggio & Powell noted that professions face coercive and mimetic pressures similar to those faced by organizations. Professionals with different skills may differ internally but share traits within similar professional organizations. Normative stress from professionalization occurs when professionals unknowingly reproduce each other's beliefs (Pi-Tzong, Hsi-Peng, & Tzu-Chaun, 2012). Institutional theory holds that actors often copy actions when most perform them. Normative pressures spread through employee filtering. Factors such as competitiveness, economic hardship, modeling, regulations, institutional pressures, culture, and strategic orientation influence organizational knowledge and behavior (Hussain & Hoque, 2002). Institutional theory explains changes in systems, processes,

and behavior. Gimzauskiene and Klovienė (2011) add that institutional factors help identify the organization's environment and its response to pressures, both internally and externally.

Structure and Agency in institutional theory

In institutional theory, two main perspectives exist: the structure school and the agency school (Hirsch & Lounsbury, 1997). The key debate between these perspectives centers on what shapes social forces: organizational behavior or the agency of organizations themselves. The structuralist perspective, supported by its "master hypothesis" from Hoffman & Ventresca (2004), suggests that over time, organizations tend to become isomorphic by adopting institutional ideals from their environment to gain legitimacy (Heugens & Lander, 2009; DiMaggio & Powell, 1983). Conversely, the agency perspective criticizes this view as too deterministic (Heugens & Lander, 2009). It argues that organizations respond to institutional pressures differently based on their internal and external experiences. Furthermore, supporters of agency believe that increased institutionalization within organizations can sometimes result in deviant behavior and foster institutional entrepreneurship (DiMaggio, 1988).

Early institutional theory research primarily examines what influences organizational isomorphism, focusing on in-field variance in which organizations imitate peers. Little work has explored how field-level factors affect isomorphic variation, partly due to data collection challenges (DiMaggio & Powell, 1983). They introduced "isomorphism" as a standard measure in institutional theory. Structuralists view isomorphism as the ideal for highly professionalized, institutionalized organizations, signaling adherence to a prototype (Heugens & Lander, 2009). Conversely, agency scholars view organizational change as possible, treating isomorphism as temporary (Scott, 2002; Heugens & Lander, 2009).

Zucker (1987) proposed that incorporating elements validated by the institution can lead to isomorphism with the environment, thereby enhancing the organization's chances of survival (p. 443). He described institutions by considering both the environment and the organization itself, stating that the institutional environment is shaped by rationality and formal elaboration (1987, p. 444). Zucker consistently emphasized that an institution's core components originate from external sources (1987, p. 445). When he referred to an organization as an institution, he noted that many of its enacted features stem from internal development or imitation of similar organizations. He also noted that organizations are crucial for institutionalizing new activities (1987, p. 446). The table below outlines the main characteristics of both the environment and the organization that serve as foundational elements of institutions.

Table 1: Major points of theoretical divergence

Aspect	Environment as Institution	Organization as Institution
Theoretical Approach	Reproductive	Generative
Motif	Growth of state	Small groups & imitation of other organizations
Source	Growth of state	Small groups & imitation of other organizations
Locus	(1) Outside organization(2) State-linked	(1) Internal process(2) Similar organizations
Outcomes	(1) Decoupling from technical core(2) Inefficiency	(1) Stability(2) Efficiency contingent on alternatives

Source: Zucker (1987, p. 445)

An assessment of positive, behavioral, and institutional theories on accounting

Based on the discussion above, positive, behavioral, and institutional theories serve as analytical frameworks drawn from various disciplines to understand specific tendencies or practices in accounting. The positive theory

of accounting emerged as a response to the normative theory, which was seen as overly idealistic and disconnected from practical realities across different economic systems. Jensen (1976) contended that much accounting research lacked scientific rigor because it focused mainly on normative and definitional aspects. He noted that theory was often equated with normative principles, and most studies focused on what "ought to be done." In contrast, positive theory seeks to explain and forecast actual accounting behaviors, following a process similar to scientific modeling (Watts & Zimmerman, 1986, p. 2).

Jensen (1976) advocated a positive theory of accounting that explains why accounting is the way it is, why accounting scholars and practitioners do what they do, and how these factors affect people and the resources they use. For the sake of argument, the emergence of positive accounting can be attributed to the success of normative accounting research. Jensen concluded that academics and accounting professionals will not answer many normative questions without the benefits of positive theory. Building on Jensen (1976), Watts and Zimmerman (1977) described the orthodox financial accounting literature as unscientific. This "unscientific" characterization stems from its emphasis on prescribing rather than developing a theory that explains why financial statements are the way they are (Watts & Zimmerman, 1977). Zimmerman (1980) noted that positive research aims to develop theory that explains observed phenomena.

Thus, we can infer that Watts and Zimmerman's (1977) characterization of positive theory concerns accounting researchers' ability to make predictions from a given set of variables. Institutional theory, according to Ma and Tayles (2009), holds that organizations respond differently to institutional stimuli. Ma and Tayles (2009) conceptualized organizations, from a neo-institutional viewpoint, as heterogeneous bodies composed of functionally differentiated groups pursuing their objectives. The authors concluded that neo-institutional theory explains changes in management accounting practices (Ma & Tayles, 2009). Institutional theory explains how organizations institutionalize rules, norms, or routines that guide organizational behavior (Gong & Tset, 2009). The authors added that institutional theory offers alternative perspectives on why organizations use certain management accounting practices.

Institutional theory, developed by Scott (2008), posits that social participants seek or reinvent legitimacy within their environment. Tuttle and Dillard (2007) added that it involves competition, diverse problem-solving methods, and economic efficiency. DiMaggio and Powell (1983) offered a sociological view, noting that institutional influences shape organizational structures more than market forces, leading to greater homogeneity. They argued that pressures from the institutional environment promote uniformity among organizations. Tuttle and Dillard (2007) further suggest that the theory explains how assumptions form beliefs that influence individual choices. Scott (2008) identifies three levels of analysis: societal institutions, governance, and actors. Behavioral theory, as Caplan (1966) noted, emphasizes the behavioral nature of management accounting, shaped by views on human behavior. Devine (1960) warned that accounting theory often contains inherent roughness, linking it closely to human assumptions.

CONCLUSION

Overall, these theories complement each other as accounting theorists choose approaches for their research. As in other fields of study, approaches evolve over time from one form to another. The normative approach, the earliest method used in accounting research, gave way to positive theory. Unlike the normative approach, the behavioral approach focuses on evidence-based studies that explain users' economic and psychological reactions under varying conditions. Accounting theory researchers use the behavioral approach to examine user behavior and reactions in the face of rational accounting choices. The behavioral approach is more descriptive than normative and seeks to identify users' behavior rather than influence it. Overall, these approaches deepen theoretical postulations in accounting.

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