Critical Perspectives on Accounting xxx (2015) xxx–xxx

Contents lists available at ScienceDirect

Critical Perspectives on Accounting

journal homepage: www.elsevier.com/locate/cpa

Discipline and punish: Exploring the application of IFRS 10 and IFRS 12

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ARTICLE INFO

Article history:
Received 6 October 2014
Received in revised form 21 September 2015
Accepted 24 November 2015
Available online xxx

Keywords:
Consolidation accounting
Financial crisis
Financial reporting
International Financial Reporting Standards
IFRS 10 and IFRS 12
Legitimacy
Panopticism

ABSTRACT

This paper uses IFRS 10 and IFRS 12 as a case study to demonstrate how a sense of enclosure, partitioning, hierarchical surveillance and normalising sanction is used to encourage compliance with new accounting prescriptions. Detailed interviews with corporate governance, financial reporting and financial regulatory experts are used to explore the functioning of Foucauldian power in a practical accounting system. Interviewees also reveal how, even if complete Panoptic control over the consolidation accounting space is not achieved, the disciplinary potential of the new standards is sufficient to support the valid expectation of compliance in the eyes of stakeholders and substitute for a loss of trust in the aftermath of corporate scandal and financial crisis.

1. Introduction

Accounting's vast 'calculative infrastructure' cannot be attributed only to a neutral means of processing and communicating financial information to stakeholders (Hopwood, 1987; Carruthers, 1995). Far from being an inert mechanism for collecting and processing data, accounting systems play a significant role in creating new fields of economic visibility and establishing domains of accountability and responsibility while constituting the dominant discourse for conceptualising the role and status of organisations (Hopwood, 1987; Roberts, 1991; Mennicken & Miller, 2012). The result has been the proliferation of technologies of accounting and accountability and the institutionalisation of accounting practice (Burchell, Clubb, Hopwood, Hughes, & Nahapiet, 1980).

Even in traditional technical renditions of accounting as a rational business 'instrument' (Watts & Zimmerman, 1976), institutional forces are present (Carruthers, 1995). The proliferation of 'functional' accounting technologies – including bookkeeping systems, budgeting and standard costing – is not only the result of economic change (Hopwood, 1987). The generally accepted role of accounting systems in modern organisations is intertwined with the formalisation and professionalization of the 'accounting craft' and its establishment as a taken-for-granted mechanism of modernity (Burchell et al., 1980, p. 7; Chandler, Edwards, & Anderson, 1993; Edwards, 2001). Consequently, the development of specific financial reporting standards becomes inseparable from the functioning of political power and trials of strength (Bengtsson, 2011), a sentiment shared by Ravenscroft and Williams (2009) who argue that neo-liberal economics and political ideology have played a significant role in shaping the focus of contemporary accounting standards (cf Zhang and Andrew, 2014). Likewise,

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http://dx.doi.org/10.1016/j.cpa.2015.11.001
1045-2354/© 2016 Published by Elsevier Ltd.

Georgiou and Jack (2011) present the evolution of fair value accounting, not only as a rational technical process but also as one heavily dependent on the perceived legitimacy of existing and emerging accounting practices by constituents.

More needs to be done to understand the 'conditions which provide the possibility for particular conceptions of the accounting craft [and] the forces which put accounting into motion' (Hopwood, 1987, p. 207). In particular, few studies have examined the link between 'accounting systems, technologies of accountability, and modes of shaping social relations' (Mennicken & Miller, 2012, p. 5) making a case for a Foucauldian-inspired analysis of financial reporting to provide an alternate perspective on recent technical accounting developments.

Several writers have applied Foucauldian theories of power and control to shed light on the functioning of the organisation (Knights & Roberts, 1982), management accounting systems (Hopper & Macintosh, 1993) or the behaviour of individuals in professional settings (Brivot & Gendron, 2011). To date, however, few researchers have considered the relevance of principles of enclosure, efficiency and disciplinary power for explaining changes in financial reporting (Mennicken & Miller, 2012). This research addresses this by considering how elements of *IFRS 10*: *Consolidated Financial Statements* (IFRS 10) and *IFRS 12: Interests in other Entities* (IFRS 12), recently released by the International Accounting Standards Board (IASB), are reminiscent of Foucauldian principles of enclosure, efficiency and normalising examination. At the same time, we argue that motifs of disciplinary power and control are effectively mobilised as part of a sophisticated legitimisation process. In particular, the enclosure of the 'consolidation accounting space', coupled with the possibility of monitoring by independent regulators, creates a valid expectation of enhanced financial reporting practices on the part of users of financial statements. Even if Panoptic control is not achieved, the appearance of structured and prescriptive accounting standards allows the IASB to respond to perceived weaknesses in existing accounting practice, securing the legitimacy of International Financial Reporting Standards (IFRS's) as a global basis for preparing financial statements.

The study concentrates specifically on IFRS 10 and IFRS 12 because they codify an established accounting practice, providing a detailed case for investigation. In addition, unlike more specialised financial reporting areas, consolidation accounting is applied by many organisations, irrespective of industry type, with the results that the principles highlighted by this paper should be broadly applicable. Finally, the release of IFRS 10 and IFRS 12 are among the most recent developments in IFRS which were specifically introduced in response to a global financial crisis providing an opportunity to consider how motifs of disciplinary power interact with changes in corporate reporting and the need to secure stakeholders' confidence.[1]

This line of research addresses not only the calls for additional sociology-inspired research in financial accounting (Mennicken & Miller, 2012). By relying on detailed interviews with corporate governance experts and institutional investors, the research explores the functioning of technical accounting requirements, free of the reductionist tendencies of scientific research methods (Hopwood, 1987; Carruthers, 1995). Finally, the research provides one of the first critical accounts on the application of IFRS 10 and IFRS 12 while adding to the critical body of research on the functioning of IFRS in an institutional setting (see Ravenscroft & Williams, 2009; Georgiou & Jack, 2011; Zhang & Andrew, 2014).

The remainder of this paper is organised as follows: section 2 outlines developments to consolidation accounting over the last decade and provides a theoretical framework for analysing results, drawing on the principles of Foucauldian power and control. Section 3 discusses the method. Section 4 presents the findings and section 5 concludes.

2. Literature review and theoretical framework

2.1. The introduction of IFRS 10 and IFRS 12

IAS 27: *Consolidated and Separate Financial Statements* (IAS 27)[2] used a control-based model to identify subsidiaries to be included in a parent's consolidated financial statements, with the aim of presenting the activities of the group as a single economic unit (IASB, 2008).[3] To ensure that those investments, which the investor controlled, were consolidated,[4] SIC *12*: *Special Purpose Entities* (SIC 12) was issued during 1998 (IASB, 2010d). It broadened the definition of 'control' to include 'special purpose entities' (SPE's) or 'vehicles' (SPV's) within the consolidation net (see IASB, 2011b, 2011a). Inadvertently, however, the standard-setter introduced what would be perceived as an alternate consolidation model, which allowed for

[1] Dealing with only two accounting standards can be regarded as an inherent limitation of this research. Nevertheless, restricting the scope of the research to consolidation accounting ensures focus and offers a detailed case on the relevance of disciplinary power in a financial reporting context.

[2] IAS 27 was issued in 1989 and was amended in 2003. At this time, the IASB did not reconsider the fundamental approach to consolidation of subsidiaries in IAS 27. In 2011, IAS 27 was superseded by IFRS 10 and *IAS 27*: *Separate Financial Statements*.

[3] For the purpose of preparing a consolidated set of accounts, IAS 27 required certain 'consolidation adjustments' to be processed, such as the elimination of intercompany balances and the parent's investment in the subsidiary company against that company's equity at acquisition. Further discussion of these principles is beyond the scope of this paper.

[4] For example, an investor holding less than 50% of the voting rights in an investee may still have control over the latter due to contractual arrangements. These entities were often on 'auto-pilot' in the sense that their financial and operating policies could not be modified except by their creator or sponsor. These companies were often formed to carry out specific activities on behalf of their investors and were referred to as special purpose entities (SPE's) or vehicles (SPV's)