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TOWARD AN EMPIRICAL INSTITUTIONAL GOVERNANCE THEORY: Analyses of the Decisions by the 50 U.S. State Governments to Adopt Generally Accepted Accounting Principles

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Abstract

We develop and empirically test an institutional governance theory for explaining the decisions by the 50 U.S. state governments to adopt Generally Accepted Accounting Principles (GAAP) for external financial reporting. We argue that institutional governance theory variables are important explanatory variables that should be incorporated into accounting choice models. Our empirical results suggests that models that do not include institutional governance variables may be under-specified. Our study employs various conceptual models of institutional governance, such as institutional theory, resource dependency and agency theory to provide a more comprehensive framework for evaluation of the evidence and to develop recommendations for future research. Although our variables were carefully selected from the agency and institutional theory literature, there could be alternative model specifications under a different set of assumptions (such as, frontier estimation techniques) or other variable measures that could lead to a different set of results. However, given the assumptions of our models and the appropriateness of our operational measures, the results appear to be stable.

Extant governmental and non-profit accounting choice literature is based on agency theory that emphasizes the economic self interest motives of bureaucrats to explain a government's choice of accounting practices. A basic assumption underlying these models is that management incentives are a primary determinant of accounting choice in the government and non-profit sector. Researchers normally defined these economic incentives as reduced net interest costs, signaling to the job market, and enhancing chances of reelection in a highly competitive election.

The assumption that economic self interest motives drive governmental and non-profit accounting policy choice is not necessarily inconsistent with the notion that self-interest motives may be determined by organizational, political and institutional factors. Institutional governance theory is important in explaining accounting choice in organizations where self-interest maximizing actors cannot exert effective influence over the choice of accounting practices because of their relative power positions in their organizations. We argue that in the governmental and non-profit sector where institutional environment and statutes often dictate the choice of accounting methods, interest maximizing accounting bureaucrats may not have the political influence or organizational clout necessary to change the accounting practices of governmental entities. Therefore, it may not always be in their professional best interests to push for GAAP adoption within their organizations.

At present, theoretical accomplishments of the institutional theory have been limited in scope to the diffusion and reproduction of successful institutional forms and governance practices. Within the specific context of governmental and non-profit accounting, a rich institutional setting exists to further the theoretical understanding of how the process of institutionalization occurs and under conditions different paths of institutionalization will take place. In other words, government and non-profit accounting sector provides a rich institutional context for helping institutional theorists in identifying how the process of institutionalization or adaptation of professional governance innovations occurs. We have just begun to exploit this comparative advantage by taking the first steps in contributing to the advancement of empirical institutional theory of accounting choice. We believe, cross state longitudinal analyses of the 50 state governments as we have done here, and cross-national (cultural) empirical analysis as it has been suggested in the recent corporate governance literature are fruitful directions for institutional governance theorists to pursue.

~~Keywords: Institutional Theory, Agency Theory, Corporate Governance, GAAP, State Governments, Political Science, Political Economy, Institutional Economics, Institutional Theory,~~

Agency Theory, Corporate Governance, GAAP, Governments, Political Institutions, Political Economy, Institutional Economics, Financia


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