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Interpreting management accounting rules – an initial study of public bodies

Abstract

Much has been written on the potentially institutionalized nature of management accounting practices in the past decade or so. In particular, the interactions of rules and routines, over time, provide explanations for the stable or changing nature of management accounting. Recent work has focused more on the conceptual nature of routines in particular. This paper will focus on an organizational environment where rules are more prevalent and explore the role of rules in rules/routines interactions. Such studies focusing on rules are lacking in the extant literature. This paper provides some evidence from initial interviews at two Irish local authorities which have recently changed internal costing systems at the behest of central government. Management accounting rules were forced upon the local authority by an external party (central government), and we explore how these rules were interpreted by actors, and thus can become routinized. This interpretation led us to examine the notions of formal versus informal rules. Based on the empirical evidence we propose a more detailed interaction of rules and routines which bring about potentially institutionalized management accounting practices than that proposed in extant literature.

1. Introduction

Burns and Scapens (2000) have provided many management accounting researchers (see for example, Dillard, Rigsby and Goodman 2004; Hassan 2005; Lukka 2007; Ribeiro and Scapens 2006; Soin, Seal & Cullen 2002; Spraakman 2006) with a useful framework to interpret change and stability in and around management accounting practices. Their framework draws on the interactions of rules and routines over time to explain change or stability of management accounting practices. It does not, however, explore these rule/routine interactions in detail.

The particular focus of this paper is management accounting rules, and how they may interact with routines. Empirical work on the role of rules in management accounting change/stability is scarce, with more work done on routines (see for example, Quinn 2011; van der Steen 2011). Quinn (2011) has provided some thoughts on management accounting rules, proposing rules *must* be documented in some fashion. While written rules are not a specific requirement of Burns and Scapens (2000), Quinn (2011) argues that conceiving rules as written is more suited to the majority of management accounting contexts. He does however concede that some organizations are likely to have more formalized and rules-based management accounting practices. As noted, empirical studies on more 'rules-based' management accounting are scarce, and it could be argued that our research on rules in the rule/routine interactions to bring about management accounting change is incomplete. But what type of organization might be regarded as one where management accounting rules are likely to be more prevalent? In this paper we explore two Irish local authorities, where management accounting practices are dictated by central government policy which is written - either as legislation or government policy documents. Thus, in such an organization, we can study the role of rules in management accounting change/stability. Our research objective is thus to interpret management accounting *rules* in an empirical setting, and in particular, ascertain in greater detail the interactions of management accounting rules and routines as originally set out by Burns and Scapens (2000). As noted by Quinn (2011), Burns and Scapens (2000) does not provide much detail of these interactions and we hope this work adds to that of both Burns and Scapens (2000) and Quinn (2013, 2011), by augmenting knowledge of the role of rules in rule/routine interactions in a management accounting setting.

The remainder of this paper is structured as follows. Section Two provides an overview of the theory underpinning the present study, by exploring extant literature. We draw particularly on the work of Burns and Scapens (2000), and some conceptual refinements suggested by Quinn (2011). This is necessary to set the groundwork for later sections of the paper. This section also sets out some conceptualizations of (management accounting) rules, as the conceptual nature of rules has not been fully explored in management accounting literature. Section Three describes some findings from initial interviews at the local authority. The final section discusses these findings in the context of the relationship of rules and routines as outlined by Burns and Scapens (2000) and Quinn (2011), as well as proposes a sequence of events to conceptualize how management accounting rules and routines may interact in a more rules-based environment.

2. Review of literature

As noted in the introduction, Burns and Scapens (2000) has been the impetus for many studies of management accounting change. Management accounting change can be (and has been) studied from many theoretical perspectives, and as van der Stede (2011) notes, is hardly a new phenomenon. Before focusing on the specific approach adopted here, some of the key approaches used to study change and stability in management accounting are now briefly outlined.

First, various branches of institutional theory have been adopted by researchers. A number of old institutional economics informed studies have provided evidence of how management accounting practices can change, although exhibiting a taken-for-granted nature (see for example, Burns 2000; Burns and Scapens 2000; Coad and Cullen 2006; Lukka 2007; Siti-Nabiha and Scapens 2005; Soin et al. 2002). New institutional sociology has also been adopted to explain management accounting change in response external influences such as political pressures, regulatory changes and cultural factors (see for example, Collier 2001; Modell 2003; Nor-Aziah and Scapens 2007; Tsamenyi, Cullen and Gonzalez 2006). Several studies using institutional phenomena such as rules and routines have also been undertaken (see for example, Burns 2000; Burns and Scapens 2000; Quinn 2013, 2011; van der Steen 2011, 2009). Second, structuration theory has been used to analyze change and stability in accounting systems. Recent examples include work by Coad and Herbert (2009) and Jack and Kholeif (2008), but as described by Englund, Gerdin and Burns (2011), structuration theory has been used in accounting research for the past 25 years or so. Third, actor network theory

has also been used to study management accounting change, although possibly less so than structuration or institutional approaches. Some examples include Alcouffe, Berland and Levant (2008), Dechow & Mouritsen (2005) and Lowe (2000).

As noted, our objective is to further interpret the interactions of rules and routines in an empirical setting. This paper is thus positioned as a study of the more micro-phenomena within institutions, that is, rules and routines and draws on the old institutional economics underpinnings of Burns and Scapens (2000). This study is less suited to the more macro underpinnings of theories such as structuration theory and actor network theory. Bearing in mind the theoretical underpinnings of Burns and Scapens (2000), the remainder of this section will first detail Burns and Scapens (2000) and some recent contributions to their work. Then, broader literature on rules is detailed. As noted earlier, research in management accounting literature on rules is less common, and to interpret how rules interact with routines as set out in our research objective, we need to understand their conceptual nature.

2.1 Rules and routines in management accounting

The work of Burns and Scapens (2000) has been used as a starting point by many scholars who adopt the concepts of rules and routines in management accounting research. A key assumption of Burns and Scapens (2000) is that change and/or stability in management accounting can be interpreted using phenomena such as rules and routines. They define routines as “the way things are done” (2000, p. 5), and rules as “the ways things should be done” (2000, p. 6). They also recognize a link between institutions and actors, proposing that institutions define relations between social groups and group members. They present the realms of institution and action within their framework, and these, in turn, represent an “on-going cumulative process of change through time” (2000, p. 9). Burns and Scapens’ framework starts with the encoding of “institutional principles into rules and routines” (2000, p. 10). This is typically influenced by existing rules and routines, which embrace existing institutional values. Rules (incorporating existing routines) are then enacted, and over time, repeated behavior forms routines and/or generates new routines which may become institutionalized. Over time too, new institutions may evolve which will be interpreted in terms of existing rules and routines; that is, there is a potential for change to occur to management accounting from within an organization. Burns and Scapens (2000) paint a

picture of slower, longer-term, evolutionary change as rules and routines interact over an extended period of time.

Quinn (2011), based primarily on the work of Feldman and Pentland (2003), raised some potential issues around the ontology of rules and routines as set out by Burns and Scapens (2000). On routines, drawing on the work of Feldman and Pentland (2003), Quinn (2011) proposed that management accounting routines can be conceived as having two dimensions, namely an ostensive dimension and a performative dimension. Feldman and Pentland (2003) describe these dimensions as follows: the ostensive dimension of a routine “may have a significant tacit component” which molds the perception of what the routine is, “may be codified as a standard procedure” and “may exist as a taken-for-granted norm” (2003, p. 101); the performative dimension of a routine is “the specific action(s) taken by people [...] when engaged in an organizational routine” (Feldman and Pentland 2003, p. 102) “at specific times, in specific places” (Pentland and Feldman 2008, p. 286). Quinn (2011) adopted the ostensive/performative conceptualization of routines based on an apparent lack of any documented rules at a case company. Without rules, he questioned could routines portray a structural quality i.e. a guiding and referring function for actions (Quinn 2011). His solution is to conceive routines as consisting of an ostensive and performative dimension (as described above), with the ostensive component of a routine providing the structure. Quinn proposes some modifications to Burns and Scapens (2000), as per Figure 1.

Quinn (2011) assumes rules are documented and need not exist. Rules are thus portrayed as artifacts of routines which may, if present interact with ostensive routines. If management accounting rules exist in a particular setting, then it is possible that the ostensive dimension of a routine is formalized as a documented rule. However, it is also possible that the ostensive dimension is at variance with rules or, as mentioned, that rules are not present. Thus, the interaction between rules and the ostensive dimension of a routine is tentative – hence the dotted lines. Thus, rules may be a visible representation (i.e. an artifact) of the ostensive dimension of routines, as the latter is not directly visible (Becker 2004; Pentland & Feldman 2008, p. 288) and where rules do not exist, the ostensive dimension shapes perceptions of what routines mean or how they relate to action in particular circumstances (Feldman and Pentland 2003, p. 101). For example, management accountants may understand the month-end routine(s) in their respective organization, without necessarily having any (documented)

rules. They are guided thus by the ostensive dimension of routines to interpret what needs to be done at month-end.

Key:

- OR = ostensive routine
- A = encoding
- B = enacting of performative routine
- C = repetition of performative routine in time and space
- D = institutionalization

Figure 1 - the process of institutionalization of management accounting practices (Quinn, 2011)

Quinn (2011) is broadly similar to Burns and Scapens (2000) and supports their underlying process. However, with reference to Figure 1, lines B and C represent the performative dimension of a routine, which is a refinement of the interactions of rules, routines and action

as originally set out by Burns and Scapens (2000). The performative dimension is thus carried out against a background of rules (if present) and/or an understanding of what is expected (i.e. the ostensive dimension), as depicted by line B. While referring to the ostensive dimension of a routine and/or to rules following the logic of Feldman and Pentland (2003), each particular acting-out of a routine has the potential to be relatively stable or result in potentially novel action, as depicted by a wavy line C. The degree of divergence in the performative routine may vary, from minor to reinvention (Pentland and Feldman 2005), implying change may range on a spectrum from relative stability to a new way of doing things. Thus, as Feldman and Pentland argue, the performative dimension of routines maintain and modify the ostensive dimension (2003, p. 107). Thus, repeated performance of a routine (i.e. action) maintains it (Feldman and Pentland 2003). Even if routines remain in existence in artifact form (as a rule) after any performance of associated routines dissipates (Pentland and Feldman 2008, 2005), then while the ostensive dimension by definition still exists it may have little or no meaning (Feldman and Pentland 2003). Thus, to maintain a routine with meaning in a particular context, the performative dimension requires regular enactment (Feldman and Pentland 2003, p. 108). On the other hand, on-going performances of routines may modify them. The performative dimension may vary in response to reflection by actors or external changes (c.f. Burns and Scapens 2000). Such changes may, over time, modify the ostensive routine – as depicted by multiple sets of lines B and C. Such changes are likely to be minor, but may also be more substantial in nature causing a shift to a new and accepted way of doing things, as depicted by arrow D. Finally, if the ostensive routine is changed through on-going variations in the performative dimension, then any associated rules/artifacts may be amended to reflect the changed understanding of the ostensive dimension.

While Quinn (2011) does not dismiss rules as an essential component of the institutionalized nature of management accounting, he does propose as follows:

“[...] if rules are artifacts of routines, then by definition routines should exist before rules. Or, more accurately, the ostensive dimension of a routine would tend to exist prior to a rule. This is not to say that routines must *always* exist prior to rules. Actions do not necessarily have to be repeated to be written as a formalized rule or artifact e.g. legislation. However, in management accounting it is more likely that routines will exist before being formalized as rules” (p. 348).

In essence Quinn (2011), while not dismissing rules as a component of Burns and Scapens' framework, nor dismissing them as important in management accounting, suggests routines are more likely to be in existence before rules i.e. rules are artifacts of routines. While this may be the case in some circumstances, it is unlikely to hold in all cases. Quinn (2011) acknowledges that management accounting in some organizations may indeed have rules in advance of routines, citing public sector organizations as an example. A further point, which Quinn (2011) does not explore is the distinction between formal and informal rules. The framework presented in Figure 1 above proposes management accounting rules are best viewed as "formal" i.e. written. Quinn (2011) seems to prefer the concept of an ostensive routine over an informal (non-written) rule, but does acknowledge that they may be similar concepts (p. 349). He does not however make any proposals as to when, how or why they may be similar concepts or how informal rules and routines might "link" together in the interactions of rules and routines as set out by Burns and Scapens (2000). Oliveira (2010) places a greater emphasis on the importance of rules in management accounting and defends the importance of informal rules. However, neither Quinn nor Oliveira studied organizations where management accounting tasks are more likely to be formalized and written in some way, or more rule-like than routine-like e.g. public sector organizations. This is not to say that *all* public sector organizations are more formalized in the way they do things, nor is it saying that *no* formalization (formal rules) exists in private sector organizations. However, public sector organizations are more likely associated with actions which are determined by, or constrained by written rules, and this paper will use such an organization as an empirical base (see Section 3). As will be revealed in Section 3, our review of literature on rules and the empirical data required us to consider both formal and informal rules to interpret the interactions of rules and routines and in a more rules-based management accounting environment.

2.2 Extant literature on rules

As portrayed in Section 2.1, it is largely accepted in the management accounting literature, that both rules and routines play an important part in the interpretation of management accounting change and stability (Burns and Scapens 2000; Quinn 2011). However, much of the extant research has concentrated less on rules and more on routines. As we focus more on rules, it is important to pin down the concept as best possible. Thus, we now detail extant

literature, primarily outside management accounting, in an effort to pin down the conceptual nature of rules.

In general, rules can be broadly described as either formal or informal (Hodgson 2006; Kingston and Caballero 2009; North 1990). As noted previously, the extant management accounting literature has not provided much detailed discussion on the nature of rules. Some rules-related works, for example Burns & Scapens (2000), Burns (2000), Quinn (2011) and Scapens (1994) while mentioning and adopting the notion of rules, do not provide much detail on their ontological nature. However, the institutional economics literature, which is drawn upon by both Scapens (1994) and Burns & Scapens (2000), provides some useful notions of the term “rules”. Searle describes rules as regulative (such as traffic rules) or constitutive (such as the rules of chess), the latter being termed a rule “when the procedure or practice [...] becomes regularized” (2005, p. 9). North (1990) defines institutions as including both formal rules such as laws and constitutions, and informal constraints such as conventions and norms¹. Pelikan (2003) describes two kinds of rules; rules-routines and rule-constraints. Rules-routines guide step-by-step behavior, possibly as a function of past and present conditions, whereas rules-constraints “set limits to possibly large varieties of permissible behaviors and actions, but usually not as severe as to permit only one specific behavior” (2003, p. 244). Rule-constraints are presented as formal (e.g. laws), whereas rule-routines are informal (2003, pp. 245-249). Hodgson describes rules as “socially transmitted and customary normative injunctions or immanently normative dispositions, that in circumstances X, do Y” (2006, p. 18), but avoids any further refinement into formal or informal properties. Hodgson further suggests conventions (c.f. North 1990) are particular instances of rules (2006, p. 18). The literature mentioned presents the possibility that rules may be written or formalized as an artifact or unwritten. Hodgson (2006, p. 18) states:

Many writers attempt distinctions between “formal” or “informal” institutions or rules. However, these terms have been used misleadingly and in different ways. Does the term *formal* mean legal, written, explicit, codifiable, or something else? The ambiguities surrounding these terms mean that they cannot be taken for granted. One is required to specify more clearly what is meant in each case or use more transparent terms such as *legal*, *non-legal*, and *explicit* instead (emphasis in original).

¹ See Kingston and Caballero (2009)

Reynaud (2005) provides a useful distinction between rules and routines. Reynaud (2005) provides three key differences: 1) rules are arrangements awaiting interpretation, whereas routines are rules already interpreted; 2) rules are explicit, routines are implicit, and; 3) routines are “a form of pragmatic resolution”, whereas rules give a “theoretical, abstract and general response” (p. 866). An interesting point made by Reynaud (2005) is that routines are interpretations of rules. This “interpretation” is a key point. If a routine is an interpretation of a rule, thus the “interpretation” may be conceptually similar in nature to the ostensive routine as proposed by Feldman and Pentland (2003). This begs the question, is the interpretation of a rule then an internalized interpretive structure? Or, in simpler language is the interpretation an informal rule.

Morgen and Olsen (2011) propose rules are “fluid”. By drawing on Searle (2005) and the works of Hodgson (2006), Morgen and Olsen (2011) propose it “would be a misinterpretation of constitutive rules to conceive of them as fixed” (p. 12). They argue that over time, rules and rule systems (institutions) can and do change in response to external events and action, for example. Briefly, Morgen and Olsen (2011) introduce the notion of a mezzo rule, which is a recodification of existing rules. This concept is an interesting one in that it is a “useful way of linking fluidity within rules to the critical awareness of the agent that follows, breaks, bends, and transforms rules” (p.4). Thus, as suggested by the term, mezzo rules are “half-way” between constitutive and regulative rules as proposed by Searle (2005). Arguably then, mezzo rules are both formal and informal.

Given the varying interpretations of rules, we take a lead from Hodgson (2006) in that we attempt to clarify their nature, as relevant to a management accounting context. First, we adopt the meaning of formal rules, at least in a management accounting context, in a similar vein to Quinn (2011) i.e. formal rules are written or documented. Second, the meaning of informal rules is less clear in the extant literature. While perhaps not the most scientific starting point, the word “informal” is described in the Online Oxford English Dictionary² as:

Not done or made according to a recognized or prescribed form; not observing established procedures or rules; unofficial; irregular.

Characterized by absence of formality or ceremony; casual, relaxed.

² This dictionary is available at <http://oxforddictionaries.com/>

The word “rule” is described as follows:

A principle regulating practice or procedure; a fixed and dominating custom or habit.
A principle, regulation, or maxim governing individual conduct.

Taking the above definition of informal first, a key element of the definition is “not observing established procedures or rules”. Thus, drawing on the language of Burns and Scapens (2000), it could be argued that routines (the way things are done) are informal in nature. However, looking at the definition of a rule above, things become more formal in that some “practice”, “procedure” or “regulation” is a core element of the definition – which seems to be supported by some extant literature (see for example Hodgson 2006; Pelikan 2003). A rule, however, in the general sense defined above, does not imply action; a point which is also echoed by Burns and Scapens (2000) (rules are the way things should be done) and Quinn (2011) (rules are written). Again, in a general sense, “informal” does not imply action - “not done or made according to a recognized or prescribed form” as per the dictionary definition above. Thus, drawing on Morgen and Olsen’s (2011) notion, an informal rule may be conceived as a fluid rule. This fluidity is an internal cognitive structure in the mind of the actor and is not “real” action. Therefore, we define an informal rule as a cognitive interpretation of a formalized written rule. Using this definition, an informal rule may have some similarities with the ostensive routine as mentioned earlier - both are tacit in nature, both may change over time. However, it is proposed here that a difference between an informal rule and an ostensive routine is in the very notion of routines implying repeated action³. Rules, as proposed by Quinn (2011) and Feldman and Pentland (2003) may indeed be artifacts in that they are a representation of, for example, desired or undesired behaviors. The existence of rules does not however necessarily imply repeated behavior (routines). On the other hand, actors may be aware of rules and never have the need or opportunity to apply them, hence arguably routines do not exist. Thus, it could be argued that the ostensive routine cannot by definition exist until some repeated actions have occurred so that a tacit understanding of “what to do” can be formed in the mind of an actor. While, the “what to do” can be formed through education and training e.g. professional accounting course, or through individual habits becoming collective routines over time, in more rules-based organizations (such as public sector organizations) it is more likely that informal rules may precede any ostensive routine. Thus, the sequence of events compared to that in Figure 1 may be altered in

³It is generally accepted that repetition is a necessary constituent of routines (see Becker (2008, 2004) for a useful summary).

such organizations, as follows: 1) a formal (written) rule is introduced to the organization, e.g. new legislation, guidelines or regulations; 2) actors within the organization interpret these formal rules, which *may* take on a fluid quality and “bend”. Thus, informal rules are formed as cognitive structures; 3) the informal rules are acted out, which over time may develop into routines by virtue of repetition (Pentland 2011), and; 4) finally these routines may, over time, influence the formation of new routines, which may be formalized as written (formal) rules.

In summary, it is proposed here that informal rules may precede routines in certain organizational contexts, or indeed may exist only as a cognitive structure and never become a routine as such - this of course presupposes a formal rule exists e.g. legislation or written guidelines. This interpretation may be particularly suited to organizations where management accounting practices are more formalized and/or dictated by external parties⁴. The next section recounts the evidence from two such organizations, Bravo Local Authority and Charlie Local Authority.

3. Empirical evidence – Bravo and Charlie Local Authorities

The remit of Irish local authorities such as County and City Councils is to supply services such as water and sewage facilities, housing, roads, planning, public libraries and fire services. Each authority is headed by the County/City Manager or an elected Mayor. The two local authorities researched in this study, Bravo and Charlie Local Authorities (hereafter BLA, CLA) are typical of any Irish local authority in the services they provide within their geographical area. Financial data, such as monetary spend, is not given here for confidentiality reasons.

3.1 Data and Methods

The present research is based on an initial study at two local authorities, BLA and CLA, and an interpretative approach is adopted (Ahrens and Dent 1998; Lukka 2007; Scapens 1990). As the primary objective is to further our understanding of the interaction of rules and routines in management accounting, semi-structured interviews were conducted with the Head of Finance and management accountants at both BLA and CLA. A total of six

⁴ In most cultural contexts, internal management accounting practices of private organizations are not regulated in the same way as financial accounting practices.

interviews were undertaken during 2011 and 2012, each lasting on average 60-90 minutes – at CLA we interviewed two management accountants, one senior, one junior; at BLA we interviewed the Head of Finance and one management accountant (see Appendix 1). Outline questions were sent to all interviewees in advance, and open-ended questions were used allowing interviewees to detail their opinions on events surrounding management accounting systems and practices. This allowed areas of interest to be explored in greater detail than would normally be possible (Adam and Healy 2000). All interviews were digitally recorded and transcribed to facilitate analysis. Additionally, we had access to internal documents such as costing manuals, presentations and training manuals. These documents provided some degree of triangulation of information gleaned from the interviews, and in some cases provided greater detail.

Interview transcripts were analyzed manually to identify management accounting rules and routines from the descriptions of management accounting practices as revealed by the empirical evidence. In the analysis, we adopted the definition of routines as set out by Quinn (2011). Rules are defined as set out in Section 2 i.e. formal rules are written in some way, informal rules are a cognitive interpretation of a formalized written rule. We used these interpretations of rules to analyze the empirical data in an effort to map out the interactions of rules and routines – see Section 4 later.

3.2 Towards a new cost accounting system

The original costing system which existed at BLA and CLA from the late 1970's was similar to that used in all Irish local authorities at that time. It was a *programme group-based system* which comprised of eight programme groups numbered 1 to 8 (see Appendix 2), and a central management charge which can be defined as “central costs, which cannot be directly related to a particular service but which form part of the total costs of delivering services” (Local Authority Costing Manual p.7, 2006⁵). All direct costs of provision of services such as housing, roads, water, development, environmental protection, recreation and amenity, education, health and welfare and miscellaneous services were captured in programme groups 1 to 8. The costs related to central management charge was not captured in these eight programme groups, nor was there an allocation of the central management charge to any of these programme groups.

⁵ This definition is from the most recent manual, as no copies of the original manual were available at BLA.

The original costing system was driven by a manual of guidelines provided by central government in 1976:

The rules from government are very much the statutory documentation that goes around and tells you how the information is to be presented and the categorization of it. The original costing system was guided by a generic guideline from 1976, which you interpreted yourself (Head of Finance, BLA).

It is a statutory document so the document would always have been there (Senior Management Accountant, CLA).

However, despite these costing guidelines from central government, the Head of Finance at BLA and the senior management accountant at CLA respectively commented on issues surrounding these original guidelines:

One of the difficulties that occurred was that as the services in local authorities evolved over time, individuals within the organizations made their own sort of decisions as to where the service costs best sat on the costing manual [...] the initial guidelines were not detailed enough (Head of Finance, BLA).

We had discretion at local level as to how we would use the coding system and provided it fitted into the national system of programme budgeting, well, that was fine (Senior Management Accountant, CLA).

As the services provided by each local authority in Ireland expanded differently over time, each individual local authority developed their own localized costing practices and ways of doing things; in effect, they interpreted the guidelines within the costing manual to suit their own organization. According to the management accountant at BLA “The costing manual tells you what to do and we stick by that except for the parts open to interpretation”. This practice of self-interpretation was facilitated by the Department of Environment’s⁶ (DOE) lack of direct operational control over local authorities. The DOE’s role is to implement government policies and to oversee the operation of local government systems. By the late 1990’s, the end result of 20 years of self-autonomous management accounting by local authorities was the presentation of annual budgets which proved less than ideal in terms of analysis to the DOE. Thus, the DOE could not rely on the consistency of costing processes across all Irish local authorities and it was unclear as to the true costs of the services provided, as recounted by the Head of Finance at BLA:

⁶ The Department of Environment is the central government body responsible for all local authorities in Ireland.

If you looked at what does the water service cost you, as a simple example, they were getting huge variances between one authority and another.

As highlighted by the above quotation, the varying interpretations of the original costing manual/guidelines in local authorities lead to ambiguities for the DOE. Therefore, in 1996 the “Better Local Government” initiative called for an improved financial monitoring system which aimed to 1) identify the full costs of service delivery by each local authority; 2) compare the service costs of similar activities over time; and, 3) use appropriate output measures to determine service unit costs. According to the Local Authority Costing Manual (2006, p.4)⁷, “the objective of the costing manual is to set out guidelines that will ensure comparability and consistency of costing data across local authorities”. In March 2005, a pilot project commenced to identify and develop an appropriate costing system for local authorities, with Kilkenny County Council acting as the pilot site. The pilot project recommended that a form of Activity Based Costing (ABC) was most appropriate. This new ABC-type costing system was rolled out to all local authorities across Ireland from January 2008. To accompany the rollout, a new costing manual was published in 2006, serving a number of functions:

- it standardized service and sub-service definitions
- provided a definition of total service costs
- defined the main expense groups comprising total gross costs
- identified the costs to be included in the central management charge (CMC)
- standardized the basis for allocating the CMC charge
- provided guidance on expenditure and activities to be included in each sub-service.

Services are the key reporting segment of local authorities and each service will normally have a number of sub-services. For example the Housing and Building Division will have a service called Maintenance /Improvement of Housing Units and this service will have a number of sub services. Table 1 below, provides an extract of typical services and sub-services as envisaged by the 2006 costing manual (see Appendix 2 for the full list of services and sub-services). It should also be noted that the Better Local Government initiative also

⁷ Although the Better Local Government initiative began in 1996, it was 2006 before a new version of the costing manual materialized.

introduced the concept of accruals-based accounting to Irish local authorities, but they are not bound by financial reporting standards.

Table 1 – extract from Local Authority Costing manual

A - Housing and Building Division

Ref	Service	Ref	Revised Sub Services
A01	Maintenance/Improvement of LA Housing Units	A0101	Maintenance of LA Housing Units
		A0102	Maintenance of Traveller Accommodation Units
		A0103	Traveller Accommodation Management
		A0104	Estate Maintenance
		A0199	Service Support Costs

According to all interviewees, in both local authorities compared to the costing manual issued in the late 1970's, the main impact of the new 2006 costing manual was to rename programme groups 1-8 to division A-H. The term “programme group” was now renamed a “division”, the programme, renamed “service”, with “sub-service” as appropriate (see Appendix 3). Additionally, an apportionment of the central management charge to services (i.e. Division A through to Division H) had to be undertaken for the first time.

In 2007, the BLA and CLA initiated a project to adopt the new ABC-type costing system. They used the 2006 costing manual to identify the main central management charge (CMC) drivers such as pension costs, information systems, law, human resources and finance. They apportioned these central costs out to the various service cost codes (i.e. services such as roads, housing) in accordance with the costing manual. For example, finance was apportioned based on the number of finance transactions, human resources was apportioned based on the number of staff, and so on. The project implementation team in both local authorities gave presentations to the local authority manager, accountants and to the management team to provide them with an explanation and understanding as to why the new costing approach had to be implemented. According to the management accountant at BLA and CLA respectively:

We met all the staff and I did a presentation to all the areas (BLA).

A very good training programme was embarked on by a lot of people in CLA so that they understood exactly where their local authority was going with its new costing process (CLA).

A major change resulting from the implementation of the new costing system was a new budgeting approach, which contained more detailed information than previous budgets. In particular, costs were reclassified in a more appropriate way according to the services which consumed the cost. Thus, more accurate service cost information was available to top management, as the management accountant at BLA noted:

So I suppose for the first time local authorities could identify the full cost of service provision. These new reports allowed all costs to be seen clearer. The costing system gave formal rules and we were able to use them informally to make changes internally to achieve greater efficiency.

This view was also noted by the Head of Finance at BLA:

The fundamental change in the new system is the introduction of a method of apportioning overhead, and drivers for each type of overhead. This means that at least you are apportioning overhead on a standard basis, whereas before every authority had it up to themselves. Most of them were apportioning based on expenditure, so the higher your expenditure the more overhead you picked up, and this really didn't reflect activity. So if we spend €10 million on a once off payment that didn't require any work or any involvement. That picked up a huge amount of overhead. Whereas the new system tries to reflect where overhead is actually being consumed and used in any circumstance.

The management accountant at BLA also noted that the complexity of service provision at the authority implied that even with the newer, more standardized (2006) approach to allocating costs, some interpretation of the rules was still required:

Although it was very technical in the beginning, anything that was not in the manual we were given was open to interpretation, to human interpretation, of where costs were to go [...] and the fear was, if our interpretation of the rules was very different from another authority, we would come out as being inefficient, even though we are not - just because our interpretation is different.

The senior management accountant at CLA indicated they followed the guidelines more rigorously, but some interpretation of the rules was still necessary in some circumstances:

We always had a system here of monitoring our activities, obviously as given our size we have to have a system of control that is appropriate to our size and complexity. So we would have had very rigorous processes here of expenditures and sign off within departments. Just maybe slight differences due to interpretation or services other authorities don't provide.

In summary, the empirical data reveals a management accounting environment driven largely by formal rules set out in various guidelines or similar over a period of 30 years or more. Problems implementing these formal rules are also mentioned, which suggests that prior to new management accounting practices becoming routinized, some form of cognitive interpretation of the rules occurred. That is, an informal rule formed, which in turn may have become a routine over time through repeated action (see Pentland 2011 for a full discussion of the necessary components of an organizational routine). Both BLA and CLA, like all Irish local authorities, had their original costing and budgeting structure driven by statutory guidelines issued by central government. These were written, formalized guidelines which were issued to every Irish local authority originally in 1976. Whether we draw on Burns and Scapens' definition of rules as "the formalized statement of procedures" (2000, p.7), or Quinn's (2011) definition of (formal) rules, both definitions would seem to apply to the local authority guidelines/costing manual. Thus, we can set out with a starting assumption that management accounting practices at both local authorities have been, and continue to be, more rules-based. In the first instance, these costing guidelines (i.e. formal rules) determine(d) the daily management accounting tasks of clerical staff, who were in the main, the staff who allocated (coded) costs incurred to various services provided by each local authority. The guidelines provided clear (formal and written) instructions on how costs for services were to be recorded within the costing system of each local authority. However, as the local authorities began to expand and offer a wider range of services during the 1980's and 1990's, the written guidelines had to be interpreted (as an informal rule) according to the context of the particular local authority. For example, at both BLA and CLA this resulted in the creation of new cost codes and internal decisions made on where to allocate revenues and expenditures for certain services; and, these "local" changes did not at all feedback to the central government costing guidelines. Nor, it would seem, were any such local changes to the written central guidelines formally documented at local level – i.e. they were cognitive interpretations, or informal rules. Thus, over time, different methods for allocating costs emerged at the local authorities, and these methods are more likely to be routines ("the way things are done" (Burns and Scapens 2000, pp.7-8)). And, as previously noted the impact of these local variants to central government was the emergence, over time, of costing and

budget reports which were not comparable between local authorities. The 2006 costing manual (see Table 1) provided more detail than previous versions, and thus as Head of Finance at BLA put it:

the principle difference is it is now clearly defined what goes where and fundamentally the option that local people had to put costs into a different programme is gone.

As mentioned previously, this inconsistent and incompatible cost reporting by local authorities led to the introduction of a new “service” costing approach in 1996 which was one of the fundamental elements of the local government reform initiative “Better Local Government”. A standardized costing manual was provided by central government which set out guidelines to ensure consistency and comparability of cost data across all local authorities. This led to local authorities altering cost classifications and allocation methods to be consistent with the new (2006) costing guidelines. Thus, changes made to the cost codes by BLA and CLA were actually acted out by the management accountants in 2006 and 2007. However, this new costing structure did not have a major impact on the daily tasks of the clerical staff; their task was mainly the same, which was allocating costs to a cost centre. However, the linking of cost centre to service provision was done by the software behind the scenes so the clerical staff did not “experience” any change in the sense that their daily tasks remained as before. According to the management accountant at BLA “we met all the staff and I did a presentation to all the areas but we did all the work for them, they had their codes so they actually couldn’t probably care less about the new system [of allocating costs]” while the management accountant of CLA noted “the primary task of the inputter (clerical staff) is mainly the same, so the inputter didn’t really care they just had to do their job and charge it correctly”.

4. Discussion and concluding remarks

As revealed earlier, adopting Burns and Scapens (2000) terminology, the costing guidelines (both the historic (1976) and new (2006)) appear consistent with the definition of rules, and here are considered formal rules. By this we mean, as per Quinn (2011), formal rules are written or documented in some fashion. The costing guidelines (original and new) were documented and outlined how service costs should be allocated and recorded in the accounting system of a local authority. In the case of apparently incomplete 1976 guidelines, if a service provided by either BLA or CLA was not typical as envisaged by the guidelines,

then management accountants made an internal decision, based on their knowledge, of where the service cost should be coded/allocated. In other words, they developed an informal rule on how certain things should be done. This is also a rule in the sense envisaged by Burns and Scapens (2000), as it suggests a way “things should be done” (pp. 6-7). Here, however, such a rule, being a cognitive interpretation of how to do things is regarded as an informal rule; it has not been documented in any formal fashion, but is yet an accepted understanding of how to perform a particular management accounting task at both BLA and CLA, at a point in time. Additionally, the formation of this informal rule in the mind of the actor does not necessarily imply that any action has been taken – in other words, a routine does not yet exist. In the case of the newer (2006) costing guidelines, these convey a closer match to the reporting requirements of a typical present day local authority, at least from the view point of central government. However, the initial evidence from interviews suggest that “informal” interpretation of the 2006 guidelines can and does occur. As noted by the management accountant at BLA “anything that was not in the manual we were given was open to interpretation, to human interpretation, of where costs were to go” (see Section 3.2). And, in the case of the original 1976 guidelines, the evidence suggests that possibly more informal interpretation occurred, as these older guidelines did not develop in line with the expanding services of BLA and CLA (see above).

Based on the evidence presented from BLA and CLA above, it seems reasonable to state that Irish local authorities exist in a more formal rules-based environment. This, at first glance is perhaps an obvious statement, as we might expect organizations such as BLA and CLA to be more formal and rule-following. The formal rules governing the authorities are statutory and written rules driven by central government, implying local authorities are compelled by statute to implement them. However, these formal rules are at an overall general level for all local authorities, and even in a small economy like Ireland variations are likely to exist among similar organizations. As this research at BLA and CLA has revealed, there may be times when some management accounting activities to be carried out by a local authority need further interpretation of the formal rules (i.e. costing guidelines), which may result in informal rules. This human cognition of the formal rules implies that rules may be fluid and incomplete (Morgen and Olsen 2011; Reynaud 2005), and thus informal rules are formed. Additionally, the findings from BLA and CLA suggest that both formal and informal rules may exist before routines in a local authority setting, which is in contrast to Quinn’s (2011) findings as set out in Figure 1, although he does acknowledge rules may precede routines in

some instances. To bring our thoughts together, the sequence of events in rules (both formal and informal) and routines terminology at BLA and CLA can be depicted as in Figure 2 (below):

Figure 2 – the sequence of rules interpretation and routine formation.

Figure 2 represents the process of the interactions of rules and routines starting at a point in time – namely, the introduction of a new formal rule. In Figure 2, we depict the sequence of events as evidenced at BLA/CLA in terms of how routinized management accounting practices – namely coding/allocating of costs – came about. First, the new formal rule is the written guideline(s) as set by central government. These guidelines clearly meet our definition of formal rules in that they are written, indeed take on a quasi-legal existence in the Irish local government realm. Second, these formal rules (both the original and newer guidelines) are cognitively interpreted by actors at each local authority. This interpretation has two possible outcomes 1) the formal rules are “complete” and clearly understood and

aligned with the organizational requirements, or 2) the formal rules are interpreted as “incomplete”. If the interpretation of rules is clear in the minds of actors, then the “complete” rule can be acted out. If organizational actor(s) perceive the formal rules as being insufficient in some way compared to the requirements of the organization, an informal rule will evolve from the cognitive interpretations of the formal rule, as the actors (at least in the context of this study) are required to follow rules. This rule is informal, in that, at least in the cases of BLA and CLA the interpretations have not been formalized (i.e. written or documented) in any way. Third, when formal rules have been interpreted as either “complete” or “incomplete”, then the rules can be acted out, and over time may become routinized - only through repeated actions (action being an essential component of routines - see Pentland 2011; Quinn 2011) can rules, whether formal (unchanged) or informal (interpreted) become routines. Thus, it is possible that routines may not actually materialize at the end of the process depicted in Figure 2 – hence the dashed lines.

In essence, Figure 2 supports the work of Ortmann (2010), who proposes that rules tell us something, but they are, in turn, open to interpretation by actors. Reynaud (2005) proposes rules are:

[...] incomplete because each one needs to be applied in the light of knowledge, of information contained in other rules, as well as custom, and practice, and context (p.850).

Reynaud’s (2005) quote above denotes a possible need for a more complete understanding of rules, to include not just human cognition, but also custom and practice (for example, routines and habits) and situational context. Thus far, no previous management accounting research divides the term “rule” into formal and informal components⁸ in a detailed study of the interactions of rules and routines. Here, the new costing rules which were applied by BLA and CLA under statute by central government are, as previously mentioned, considered formal rules. However, there are examples of informal rules also (as set out in Figure 2). For example, the earlier quote by the Head of Finance BLA (Section 3) highlights this:

⁸ While Burns and Scapens (2000) use the terms “formal” and “informal” they do not apply these to rules in their framework.

As the services in local authorities evolved over time, individuals within the organizations made their own sort of decisions as to where the service costs best sat on the document.

Interestingly, this quotation is very similar to evidence found by Lukka (2007), where he quotes a Controller of Southlake-Green Corp, USA (p. 95):

So I think that when using the manuals or doing the reporting, you have to exercise a certain amount of common sense. And try to plug things in and where they best fit.

The above quotations demonstrate that formal rules had to be “interpreted” (Morgen and Olsen 2011; Reynaud 2005), as we depict in Figure 2. This was certainly the case where various costs and services at BLA/CLA did not match the cost allocation rules set out by central government. However, as shown by Table 1, with the 2006 costing manual there are many divisions, services and sub-services which are clearer than the initial historical guidelines from 1976 (see Appendix 2), as noted by the Head of Finance at BLA. Thus, the “complete” to action link as depicted in Figure 2 represents instances when the actors at BLA/CLA can simply implement the rules as given- without interpretation – and it would seem this path through Figure 2 is more likely post 2006. On the other hand, pre-2006, the rules set by central government were less detailed and thus “incomplete” and required interpretation. Although, the “complete” path is more likely now, we also found evidence of “incomplete” formal rules, leading to informal rules after 2006. As reflected on by the management accountant at BLA the 2006 guidelines will like their 1976 predecessor, not cover every eventuality. Thus, in terms of the interactions of rules with routines, we maintain the “incomplete” path in Figure 2.

In comparison to the process set out in Figure 2, Burns and Scapens (2000) consider rules to symbolize, to an extent, the formal realm of management accounting (institutions), while routines are more representative of the informal realm. Our findings as presented in Figure 2 suggest that rules may span both the formal and informal realms. We could go further and suggest that informal rules may also be considered similar to the ostensive element of the routine as described by Quinn (2011) and Feldman and Pentland (2003). The ostensive dimension of a routine may have a significant tacit component (which is similar to informal rules), it may be codified as a standard procedure (i.e. formal rule) and it may exist as a taken for granted norm (comparable to informal rules). However, it must be remembered that the

ostensive dimension refers to the routine and, to be deemed a routine, repeated action is implied (Becker 2004; Pentland and Feldman 2003, 2008; Pentland 2011). Action, in the sense of doing a task, is not part of our definition of informal rules, and although action may result following the cognitive interpretation of formal or informal rules and may become a routine (see Figure 2), this need not necessarily always happen. In addition, Burns and Scapens (2000) do not clarify whether it is rules or routines which initially guide management accountants in their daily tasks. Quinn (2011) attempts to clarify this (see Figure 1) by proposing that ostensive routines are more likely to be in existence before rules.

However, our initial findings suggest that in the interactions of rules and routines, rules may precede routines, at least in the context studied here. While it is not possible to draw definite conclusions from this research, it would appear that whether rules or routines precede each other is dependent to some extent on the context of the organization. If an organization has little or no formalized (documented) rules, routines may precede rules as described by Quinn (2011). However, in the case of more regulated organizations like BLA and CLA, which are primarily driven by formalized rules (in the form of government guidelines and legislation), then it appears more likely that rules precede routines in the formation of routinized management accounting practices at least in some organizational contexts. Quinn (2011) argues that routines are more likely to precede rules in a typical for-profit management accounting context, particularly in small and medium-sized businesses. Here, we provide initial evidence of the opposite. However, a brief comparison of the work of Quinn (2011) as seen in Figure 1, and our work as per Figure 2, does suggest a differing slant on the *process* of how routinized management accounting practices come about in certain contexts through the interactions of rules and routines. However, the key underlying principles of Quinn (2011), our work here, and Burns and Scapens (2000) remain the same. In other words, the interaction of rules and routines is useful to interpret how management accounting practices can become routinized over time; we fully support this, but offer a more detailed view of these interactions based on our empirical evidence from BLA and CLA.

Reflecting on our research objective, what does Figure 2 mean for our understanding of the interactions of rules and routines in a management accounting context? As noted earlier, Burns and Scapens (2000) did not necessarily provide clear definitions of either rules or routines. Quinn (2011), based on Feldman and Pentland (2003), provides some clarity on the nature of routines and some management literature has adopted these more detailed

conceptualizations of routines (see van der Steen 2011). However, further conceptualization on rules post Burns and Scapens (2000) has been lacking in management accounting literature. Here, we have shown that at least in some organizational contexts, formal rules can be the trigger for (eventual) management accounting routines. However, the evidence from our case organizations as conveyed in Figure 2, supports what Reynaud (2005) and Ortmann (2010) propose, in that rules can be interpreted by actors. However, as shown in Figure 2, the interpretation of a formal rule cannot be termed a routine, and thus we conceive this interpretation as an informal rule – which when acted out may become a routine. Figure 2 also shows that rules can perhaps be simply enacted, once they are clear (or “complete” in our terminology) and are aligned with organizational requirements. Over time, the “complete” or “incomplete” (formal or informal) rules may be enacted repetitively and become routines.

The work presented here does have a number of limitations. First, the findings of this research are limited by the fact that they are interpretative and driven by the context of the organizations studied, which may include cultural or country-specific factors. Second, given the initial nature of the research, an obvious limitation is the extent of the interviews. Third, our framework is based on initial research and thus, to increase the validity of our proposals, future research in similar settings is required. Fourth, although we refer to the interactions of rules and routines throughout this paper, we have not studied the routines *per se* in that we have not interviewed actors who perform many of the daily management accounting tasks. This would of course provide a richer story of change and/or stability, but our objective in the first instance is to concentrate on the interactions of *rules* with routines. It is reasonable to assume that if a formal or informal rule is acted out repeatedly over time, it will maintain a general pattern of action over time (Pentland 2011). Finally, we do not attempt to delve into the human cognition component as depicted in Figure 2. For example, we do not consider the sense-making and experiences drawn upon by actor when they interpret a new formal rule. Rather, we perhaps somewhat simplistically portray it as part of a process of how routines may come about in certain organizational settings. How actors interpret rules may be influenced by a myriad of factors such as power/politics, internal and external structures, other actors in a network (Stones 2005), the external business/economic environment, personal habits, professional background and so on. While this may be a limitation of Figure 2, it is likely to be a very fruitful future research area.

However, while keeping the limitations in mind, this study potentially contributes to the continued understanding of concepts drawn on by Burns and Scapens (2000) i.e. rules and routines. As with the work of Quinn (2011), this study is by and large supportive of Burns and Scapens (2000), but does offer some potential broadening of our understanding of rules in particular, and their interaction with routines. Further more detailed studies of more rules-based organizations like the two local authorities presented here will serve to broaden our understanding of the processes of institutionalization and routinization of management accounting practices as originally set out by Burns and Scapens (2000).

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Appendix 1

Interviewee details

<i>Organization</i>	<i>Role</i>	<i>Length of interview</i>
CLA	Senior Management Accountant	65 mins
CLA	Junior Management Accountant	72 mins
BLA	Head of Finance	85 mins, 61 mins
BLA	Management Accountant	92 mins, 65 mins

Appendix 2

Programme Group	Programme
1. Housing and Building	1.1 Local Authority Housing 1.2 Assistance to Persons Housing themselves 1.3 Assistance to Persons Improving Houses 1.8 Administration and Miscellaneous
2. Road Transportation and Safety	2.1 Road Upkeep 2.2 Road Improvement 2.3 Road Traffic 2.8 Administration and Miscellaneous
3. Water Supply and Sewerage	3.1 Public Water Supply Schemes 3.2 Public Sewerage Schemes 3.8 Administration and Miscellaneous
4. Development Incentives and Controls	4.1 Land Use Planning 4.2 Industrial Development 4.3 Other Development and Promotion 4.5 Director of Community & Enterprise 4.6 Twinning of Local Authority Areas 4.8 Administration and Miscellaneous
5. Environmental Protection	5.1 Waste Disposal 5.2 Burial Grounds 5.3 Safety of Structures and Places 5.4 Fire Protection 5.5 Pollution Control 5.8 Administration and Miscellaneous
6. Recreation and Amenity	6.1 Swimming Pools 6.2 Libraries 6.3 Parks, Open Spaces, etc 6.4 Other Recreation and Amenity 6.8 Administration and Miscellaneous
7. Education, Health and Welfare	7.2 Education

	7.3 Health and Welfare 7.8 Administration and Miscellaneous
8. Miscellaneous Services	8.3 Financial Management 8.4 Elections 8.5 Justice and Consumer Protection 8.6 Property Damage 8.7 Markets and Abattoir 8.8 Administration and Miscellaneous 8.9 Lord Mayor's Allowance 8.10 Lord Mayor's Entertainment & Travel Allowance etc 8.11 Expenses of Members of Local Authority & Representation at Conferences 8.12 Expenses of Members Attending Conferences.

Structure

EXISTING VS. NEW COSTING STRUCTURE