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Article (Accepted version) (Refereed)

Original citation:
Power, Michael (2018) *Accounting, boundary-making and organizational permeability*. Research in the Sociology of Organizations, 57. pp. 31-53. ISSN 0733-558X (In Press)

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Available in LSE Research Online: May 2018

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Forthcoming in **Research in the Sociology of Organizations** 2018

"Towards permeable boundaries of organizations?"

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ACCOUNTING, BOUNDARY-MAKING AND ORGANIZATIONAL PERMEABILITY

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Author biography

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ABSTRACT

Financial accounting necessarily depends on an entity assumption which shapes the way it recognises and accounts for organizational exchanges with social environments. It thereby constructs boundaries and frames permeability in terms of what counts, is accounted for, as being inside and outside of the organization. Yet there are different possible entity concepts reflecting different values about the relationship between the organizational entity and society. This essay considers four problem areas in which these values and the entity-society relationship are at stake within financial accounting: the problem of control within group accounting; accounting for externalities; the economization of public organizations; and the construction of organizational actorhood. These four problematics suggest that financial accounting, its boundary determining assumptions and the forms of organizational permeability it permits, are deeply intertwined and subject to continuous pressure for change.

KEYWORDS

Research Paper: Accounting, Actorhood, Boundary, Entity, Permeability, Organization

INTRODUCTION

Organizations are embedded in society in multiple ways. Institutional theories show how society flows into, shapes and is itself shaped by organizations, so much so that it is trivial to assert that organizations are social entities. Yet organizations are characterised by multiple boundaries which, though also social and institutional in nature, seek to separate organizations from, and control exchanges with, their environments. In short, boundaries have a dis-embedding effect in limiting and shaping how society 'gets in'. Such boundaries are necessarily fictions, but they are fictions which underpin the institutionalization of organizations as relatively discrete entities which interact with each other and which transact with their environments. These institutional conditions of boundedness and closure constitute, and are intertwined with, the kinds of openness and permeability that define organizations.

The law has played an important historical role in entity construction, moving beyond organizational collectives which remain fundamentally grounded in their human members, to create non-human entities capable of contracting in their own name, of becoming responsible actors in their own right, and of owning property. Yet these legally constituted entities and their constituted autonomy may be only be loosely coupled to other less formalised boundaries and modes of permeability based more on relationships and alliances, and on the enduring importance of human networks. Thus, there is no necessary alignment between formal organizational boundaries and *organizing* understood as an on-going process. Where an organization begins and ends may also be relative to the institutional (and theoretical) optic employed and for

what purpose. Indeed, the question of organizational boundaries and permeability is not only technical in nature; it raises issues of value: what are organizations for and who do they serve? And from this viewpoint it follows that boundary-permeability configurations may be multiple and contested.

In this essay, we consider how financial accounting is deeply implicated in this construction of organizational boundaries and its controversies. Specifically, we explore how accounting both defines and mediates the boundary between inside and outside in the broad sense of the relation between organizations and their environments, or what we shall call ‘entity’ and ‘society’, yet it is also subject to pressures to change that boundary. In short, financial accounting must manage a continuous tension between ‘keeping society out’, but not too much in order to be responsive, and bringing society back in, but not too much in order to maintain entity coherence.

Financial accounting consists of core technical components: income statements; balance sheets; cash flow statements; and supporting explanatory notes. Although this data can exist in multiple forms, the core financial statements are conventionally published in the form of an annual report. The latter normally also contains a broader narrative providing the wider context of the organization and other metrics, often of a non-financial nature. Financial accounting is commonly understood and taught as a set of procedures and techniques for making organizations more transparent, and thereby making its leaders accountable to specific outsiders. It is claimed that financial accounting for companies enables their actual and potential shareholders to make better decisions about capital allocation because vital information about costs,

income, assets and debt is disclosed to them. According to this myth of transparency (Christensen & Cornelissen, 2015), financial accounting can be viewed as a window between the 'inner' operational world of the organization and its outside. The window may not always function as the external world would like – there may be fraud or the accounting rules may be imperfect, but accounting is conceptualised primarily as a neutral relay, which merely 'intermediates' (Latour, 2005) between organizations and their environments. It is conduit or membrane for information to flow between organizations and their institutional environments, thereby managing and reducing uncertainty (Meyer, 1986). Importantly, this intermediating model of accounting assumes that it is a practice which is somehow independent of the accounted-for organization, an assumption which the remainder of this essay will challenge.

Modern financial accounting practice is relatively young, designed approximately 150 years ago for an industrial age in which the largest organizations essentially took the tangible form of factories and plants. The boundaries of the organization could often be thought of in physical terms: supplies arrive at a factory gate, are converted into valuable outputs and then physically leave when sold. As is well known, the factory as a physical organizational form solved the coordination issues associated with loose networks of dispersed sub-contracted production sites, and forms of accounting and bookkeeping were designed to control not only flows of goods into, within, and out of the factory as an accounting entity, but also flows of people.

Residues of this physicalist/manufacturist conception of organization, which can be found in classical organizational sociology of Weber and others, are still to be found

in the structures of modern financial accounting. Indeed, financial accounting continues to be challenged by conceptual and measurement difficulties in dealing with the rise of the intangible economy and in representing more fluid and hybrid organizational forms which are increasingly prevalent in the twenty first century. Such developments have made organizational boundaries problematic and fuzzy, and readers of formal accounts must turn to disclosures about so-called 'related parties' to get a preliminary sense of the networks which span these boundaries.

These developments, which are well documented in accounting and management scholarship, reveal that a clearly bounded entity, even if organizationally non-descriptive, is a condition of possibility of financial accounting. For modern financial accounting to work it must define what is inside an entity, what is outside of the entity, and what passes between the two as a trans-action. This means that financial accounting does not only represent organizations, it performs them as specific and formal accounting entities according to a logic which may or may not be well-aligned with their operating reality.

In the remainder of this paper, we explore several aspects of this boundary-constituting function of accounting in more depth, and the tensions that pervade it. We begin by discussing the centrality of the so-called 'entity assumption' to accounting and argue that this assumption reflects deeply institutionalized values about ownership and rights to exercise control. Yet this accounting boundary construction is also a society-entity interface which is essentially dissonant and never settled or free from controversy. How does financial accounting manage and represent the value-laden relationship between organizations and changing societal-level issues?

To answer this question the essay considers four different but related problematics of accounting boundary-making. First, the technical setting of accounting for groups as 'meta-entities' is discussed, focusing on the problem of defining the boundary of a group in terms of managerial control. Second, we develop a more critical reading of accounting boundaries and argue that they are a site for an environmental politics focused on the reinternalization of externalized costs, such as pollution. Third, we invert the internalization problematic and show how, under specific circumstances, accounting functions to economize public organizations as entities capable of succeeding and failing irrespective of their external costs and benefits. Fourth, we consider how financial accounting is implicated in the construction of organizations as purposeful and responsible actors, making them both highly rationalised but also vulnerable and permeable to the expectations and risks posed by society in the form of stakeholders. These four problematics suggest that boundary-making and organizational permeability are deeply intertwined issues, that they are dynamic and a source of continuous change, and that accounting should be at the heart of any discussion of them.

THE ACCOUNTING ENTITY ASSUMPTION: PROPRIETORIAL OR SOCIAL?

Early in their studies, new accounting students are taught that the entity concept is the one of the most fundamental, determining what is included as a matter of account and what is not (Weetman, 2011, chapter 1). A clear definition of the accounting entity is a condition of possibility for doing any financial accounting at all, since it determines which transactions are to be accounted for as part of the entity and which not. As we

shall see, this is no trivial matter and yet, as they become increasingly technically proficient, and socialized into the accounting view of the world, the significance of this assumption and the dependency of accounting on it recedes from students' view. The accounting entity has become more or less naturalised and institutionalised. However, when technical and practical accounting problems arise, they reveal that accounting and organization and not identical and this inevitably brings the accounting entity assumption back to the surface of discussion, not least because it is not a single and unequivocal concept:

'The entity is variously regarded as a proprietary unit, an economic unit, a managerial unit, a social unit, and a collection of rights and restrictions on their exercise' (Meyer, 1973, p.116)

Thus, an accounting entity concept which emphasises the rights of specific owners reflects the traditional *proprietary* view of the accounting entity i.e. that the firm is simply an instrument for owners who have claims over the net assets of the organization to increase their personal wealth. The accounting must reflect that relationship. A small family company might be a good example where this proprietary idea makes sense, but even the proprietary approach can vary in its respective definitions of 'owners'. Indeed, the very notion of an 'owner' is itself not unproblematic. For example, in the case of a company equity shareholders only own shares which are rights over net assets: they do not legally own those net assets directly (the corporate legal entity does). This suggests that the proprietorial accounting entity concept is itself nested in a web of legal precepts (Biondi et al.,

2008) pointing to an intimate conceptual relationship between law and financial accounting (Freedman & Power, 1991).

In contrast to the proprietorial idea, the *pure entity* concept of the accounting entity posits the organization not just as an instrument for, and extension of, its owners, but as something more discrete in itself with multiple possible purposes. From this point of view, the accounting entity is more of an autonomous institution – an actor in its own right - with a stronger boundary than the proprietary concept between itself and owners like shareholders, who are remote providers of capital. This accounting concept seems to be more aligned with the economic and managerial reality of the large public corporation which pursues its purposes, subject to being accountable to creditors and shareholders as *outside claimants* on the net assets which are in effect controlled by the entity. The law relating to corporate personality provides conceptual support for this more autonomous entity concept (Ireland, 1996). Furthermore, as we shall see below, organizational sociology has built on this idea yet further to understand formal organizations culturally as discrete rational actors in their own right (Jeppersen & Meyer, 2011).

An important conceptual variant of the pure entity view of the accounting entity is the so-called *social entity* concept which focuses on: 'the role of the business enterprise in satisfying the many demands of society including those of employers, creditors, lessors, stockholders, customers, suppliers and the community at large' (Meyer, 1973). From this point of view, the accounting entity is still an instrument, but it is an instrument for social purposes whatever they may be, such as in the case of a cooperative or a mutual organization which exits for the benefit and security of its

members. Strictly speaking the ‘social’ accounting entity owns no assets and enjoys no income – it is simply a vehicle with a ‘license’ for pursuing specific social goals.

These different accounting entity concepts are cultural forms and have emerged in specific historical settings. They are specific but largely invisible institutional design choices about which aspects of organizational activity and economic relationships are to be accounted for, and which not. Furthermore, they rarely exist in their pure form. Elements of both proprietorial and pure entity concepts are embedded in the legal frameworks in different jurisdictions and reflect tensions about what to account for and to whom. Indeed, despite their apparent institutional stability and invisibility, the different nuances of the accounting entity concept suggest that it is not coherent or consistent foundation for accounting and from time this becomes visible and are a source of fierce debate and controversy.

For example, in the United Kingdom in the early part of the twenty first century a fundamental review of company law took place (DTI, 2001). A key question at stake was how and whether to base the design of company law on a relatively more proprietorial view or a relatively more social view of the enterprise. In the end, supported by arguments of efficiency and operability, the proprietorial view and the primacy of the equity shareholder prevailed. However, there was an important concession to the social entity view in the form of the Companies Act 2006 section 172. This section places a duty on company directors to promote the success of the company “for the benefit of its members as a whole”. In doing this, a director must have regard for inter alia: the interests of the company's employees; the need to foster the company's business relationships with suppliers, customers and others; and the

impact of the company's operations on the community and the environment. In effect, the proprietorial and social entity views were combined, but with a clear priority for the former.

Another period of what might be called ‘accounting entity’ controversy was visible in the aftermath of the financial crisis of 2009 in the United Kingdom. Banks had accounted for themselves as autonomous actors in the normal way as proprietorial-entity hybrids. As these banks failed and required taxpayer funding for their continued existence, it became evident that citizens as taxpayers, rather than shareholders, were the banks’ real and hitherto invisible proprietors and risk-bearers of last resort. Banks became permeable to societal level concerns and many argued that banking organizations should be reconceptualised and accounted for, at least as regards their retail banking operations, as utilities with a public purpose i.e. as social entities. There followed a period of much discussion focused on the question ‘what are banks for?’ (e.g. Gobat, 2012). And yet, despite this very public problematization of banks as organizations, the underlying entity concept of banks and their accounting did not change.

In other settings, the tension between proprietorial and social entity accounting concepts is more visible and continuous. For example, in the case of organizations with an explicit public purpose, such as universities and museums, different entity concepts live uneasily with one another and continuously raise the question of purpose. In the museum setting, different entity concepts underpin different ways to account for so-called ‘heritage assets’. When the museum is regarded as an autonomous entity, they are assets of the entity and appear on the asset side of the

balance sheet. However, a blend of proprietorial and social entity concepts would position heritage assets as assets of society, held in trust by the museum organization for society and future generations. Indeed, one might even regard them as liabilities of the organization because they are lent by their owner – society. In effect, heritage assets would be assets on the balance sheet of society, were such a thing to exist, and liabilities of the museum. In practice, they are represented and accounted for as assets in the traditional way (Barton, 2005), but this is more a matter of pragmatism and the difficulties of operationalising the social entity view, rather than any underlying conceptual coherence. It means that accounting for organizations like museums is essentially dissonant. This dissonance or entity pluralism is 'managed' within the narrative of public disclosure documents, such as an annual report, largely by avoiding it. Thus museums, universities and other social purpose organizations will separate the financial accounts from other aspects of the annual report which deal with the achievement of social purposes and which try to measure and account for social impact.

In summary, accounting 'entity' constructs seem to be merely conceptual assumptions but they are much more than that. As historically emergent norms, they are bearers of competing values and conceptions of the enterprise, and are therefore in principle political in nature. The proprietorial, pure entity and social entity concepts can be understood as different values underlying different possible accounting representations of the boundaries of organization. The proprietorial view positions the organization as an extension of its owners, whereas the entity view sees it as more autonomous and self-directing. The social entity view seeks to reflect and account for the social purpose of the organization.

These are three different ways of conceptualising and configuring the organization and its boundaries according to an accounting logic i.e. for deciding what is to be accounted for as part of an organization and therefore visible, and what is not. Accounting entity concepts, and therefore financial accounting, are institutional fictions which represent and repeatedly perform the boundaries of the organization in their own way. They define specific forms of *accounting closure* which determine the kind of openness and permeability that they permit. Yet, as we shall see, they are also continuously problematic and contentious. In what follows we consider four problematics or themes in which these accounting entity concepts are implicated in the representation of organizational boundaries. We begin with the seemingly technical problem of group accounting.

BOUNDARIES OF CONTROL: WHAT IS A GROUP?

One of the technical accounting areas where the entity debate is more than theoretical is that of 'group' accounting. The group as an organization is an economic 'meta-entity' over and above the individual legally constituted economic entities which comprise that group. How can this meta-entity be represented by accounting? The problem is analogous but not identical to the notion of the meta-organization (Ahrne & Brunnson, 2008) as an organizational form whose members are other organizations. The boundary issue is how to determine the limits of membership. In the case of meta-organizations such as trade associations, the boundary between a member and non-member is relatively clear. In the case of the boundaries of a group, it is

necessary to determine which entities are 'inside' it and how they should be represented. This is not always simple.

Conceptually, accounting for a group boils down to the boundaries of management control. Entities are accounted for within a group where there is evidence that they are *controlled* by group management as a central directing agency. Control can be understood as a form of organizational permeability. That is, where an organization is said to control another, the controlled organization is permeable to its influence. But what is control?

Control is conventionally indicated for accounting purposes in terms of the percentage of equity owned by an investing company. Once control as defined by equity shareholding is known, the accountant is able to define the residual non-controlling interest in a group of companies. The historical presumption is that ownership of greater than 50% of equity confers control and in this case the owned entity must be included in the group. In technical terms this usually means that all of the net assets of the entity are under the control of the group and there is a minority or *non-controlling* interest for the remaining percentage of shares held externally. However, even this is not as clear cut as it seems.

Equity ownership is a proxy for the kind of control that can be exercised by an investing company. Thus, if a company owns 20% or less than the equity, it is normally deemed not to have control and therefore simply accounts for its ownership interest as an investment at fair value. If the parent owns between 20% and 50 % of the equity, it is presumed to have a *significant influence* but not a controlling interest

over the investment, and therefore adopts what accountants call the 'equity method' which includes a proportionate share of the net assets of the investee company in its group accounts. Finally, if the parent owns in excess of 50% of the equity, there is a presumption of control and it adopts the *consolidated* method. However, over time several possible accounting methods for consolidation have competed for institutional favour. The technical differences depend in part on the underlying entity concept adopted. For example, a proprietorial entity assumption would include *all* the assets and liabilities of the investee company at fair value, a number for *goodwill* to reflect the excess paid over that fair value of net assets, and a single line number to reflect the non-controlling interest, i.e. the claims of the non-controlling shareholders on the net assets of the subsidiary.

Stepping back from these technical accounting details, we need to ask what it is that accounting rule-makers are trying to represent about the substantive economic relationship between an investing company and its investee company. For example, an acquiring company may pay a premium to invest in another because of anticipated synergies with the new business, and this premium is reflected in the 'goodwill' number. However, if A owns 51% percent of B are there really these kind of real synergies with all 100% of B? How much more credible are the claims about future synergies if A owns 95% of B? And if A owns 51% of B but A and B are in somewhat unrelated industries and will continue to operate fairly independently, the synergies seem less likely. So what does any premium paid for control, if that exists, really reflect? Perhaps there is some anticipated knowledge transfer or new managerial capability? Ultimately, how might companies represent (or hide) that a

51% ownership stake is tenuous (because for example of internal management fighting?) and that the 49% “minority interest” is rock solid?

Thus, once one looks below the equity ownership proxy for control into the economic and managerial substance, the concept of control is more problematic and the boundaries of the group - which entities are in and which are out - are more indeterminate than accounting rules suggest. Furthermore, a tension emerges between the accounting representation of a meta-entity like a group, and other concepts of organization which may be based on more intangible factors such as relationships. Group accounting practice aspires to represent the underlying economic reality of these relationships in terms of entities under the control of a central, investing entity, with external interests as some kind of residual claim over the net assets of the subsidiary company. But the concept of control, on which this aspiration depends, is not strictly binary. There can also be forms of influence or the lack of it which do not correlate with shareholdings. For example, it is well known that powerful retailers with significant purchasing power can exert significant influence over the actions of smaller entities which supply it, without any equity interest being at stake. This means that determination of group boundaries in terms of control are always contestable when the real issue is the economic and managerial substance of the relationships between economic entities. These relationships may or may not involve equity interests as we commonly understand them.

All this means that the accounting ‘group’ is a very imperfect representation, at best an approximation, of the meta-organization and the boundaries of control and influence of a guiding managerial centre. And yet group accounting also to some

degree performs that meta-organization as a coherent actor. Group accounting as an institutionalised practice operates *as if* control is correlated with patterns of ownership. But in a world of joint ventures, supply chain management, strategic alliances and other network organizational forms which blur boundaries, the *fiction of control* with sharp distinctions is hard to sustain. Furthermore, social entity issues are at stake in group accounting. We know that accounting rules for group boundaries can be exploited – famously in the case of Enron (Benston & Hartgreaves, 2002). 'Special purpose vehicles' (SPVs) were used in this case as 'fake' accounting entities designed explicitly to fall below the consolidation threshold, and outside of formally defined control ratios, in order to hold debt and other risky assets. From a group point of view, such risks were literally invisible to investors as they were 'off balance sheet'.

Furthermore, as the collapse of Lehman brothers showed so clearly, under conditions of stress, an accounting group falls apart into its constituent legal entities with their own assets and liabilities, which may end up in different jurisdictions to the disappointment of creditors. Insolvency therefore restores the fictional status of the group meta-entity and the proprietorial interest of creditors dominates the construction of the stressed or failing individual accounting entities. Indeed, the process of insolvency could be said to resolve the tension between accounting and organization. Under conditions of insolvency, organizations are reduced to a balance sheet of, usually problematic, assets and claims over them.

Groups are a very technical area of financial accounting and the analysis provided above is simplified. Yet this is an instructive case setting to begin our exploration of

the tension between accounting and organizations. As noted earlier, the institutional fiction is that accounting represents an entity – an organization or group of organizations – which is independent of the accounting itself. From this point of view accounting is assumed to be a neutral 'intermediary' in Latour's (2005) sense which simply reveals the economic reality of the organization and makes it visible and 'readable' to others. And indeed, for many groups which contain only 100% owned subsidiaries under tight central management control, this is how the accounting seems to work.

Yet the problems of defining control noted above, also reveal that accounting is not this neutral window on an economic group. It is difficult for accounting to deal with relationships of influence and control which are not correlated with ownership patterns and the core accounting statements are only coherent where there are clean entity boundaries. This means that accounting embodies decisions and rules which seek clean technical boundaries when such clarity and unequivocality is impossible. Furthermore, the 'group' is itself an actively constructed accounting fiction in the face of other ways of thinking of collective entities. And, for all its technical problems, this accounting fiction is also 'ontologically performative' (Butler, 2010) in that it repeatedly brings about the institutional reality of the group as a meta-entity. This ontological achievement by group accounting is twofold. First it fixes the boundedness of a group as an entity. Second, and relatedly, it constitutes the fiction of the central controlling proprietorial investor-actor. By accounting fiction, we do not mean that groups do not exist. On the contrary, as we develop further below, we are institutionally compelled to act as if groups are real and in accounting for them we make them real.

CRITICAL ACCOUNTING: 'BRINGING SOCIETY BACK IN'

The discussion so far suggests that financial accounting does not simply 'mirror' the difference between the inside and the outside of the organization. It is a technology for seeing and constructing that difference, and thereby organizations and their formal boundaries. The shaping of these boundaries, also determines 'what counts' as an exchange across it them i.e.the formal permeability in accounting terms between the inside and outside of an organization. In short, organizational permeability and accounting boundary construction may not be identical as we shall see, but they are deeply related to each other.

Notwithstanding the conceptual plurality of entity concepts and accounting boundaries, the institutionally predominant form for large organizations is the pure entity concept which treats organizations *as if* they are discrete actors separate from the environment, including the owners and creditors to whom they owe duties in law. In short, modern financial accounting practice embodies and reinforces a form of organizational individualism and separatism. Furthermore, this entity concept is descriptive because organizations also *perform* the very individualism and autonomy which is embedded in the underlying entity concept.

Yet, this particular mode of accounting boundary construction accounting is sometimes rendered problematic and challenged, as it was in the immediate aftermath of the financial crisis noted above. If only briefly, via their systemic properties banks became visible discussed as 'social entities'. Indeed, the system of banking was

revealed under stress not as a collection of interacting individual autonomous entities but as an important public utility, a social meta-entity which could not be allowed to fail. The banking system came to understood, too late of course, rather like a meta-group defined not by managerial or regulatory control but by the risky interconnections between the balance sheets of individual banks in the group. Prevailing forms of accounting and enterprise risk management failed because their shared entity assumptions and fictional form of boundedness rendered them and their regulators intellectually unable to account for the space and relations *between* these entities, spaces where the risk of interconnectedness incubated until they were triggered by the loss of liquidity in the interbank market (Power, 2009). Banking organizations became suddenly permeable to risks which were incapable of *recognition* in the prevailing financial accounting, auditing, credit rating and regulatory system.

In a different context, Hines (1988) analyses this general problem of ‘recognition’ and uses the device of the master and pupil to explore and problematise the boundary-creating properties of accounting. At the beginning of the paper, the master points to a factory and asks the pupil what an organization is - in the sense of what is and is not part of it? Accounting, we and the pupil are told, is active in deciding this question, in determining what is and is not in the organization. Financial accounting is, far from being natural and self-evident, a collective choice about the boundaries of the organization. Accounting elements such as the ‘assets’ of the organization are made real via techniques for their ‘recognition’. The production of surplus or profit by the organization is made real by the ‘realization’ of the income and expenses of the organization. In respect of the latter, accounting chooses what does and does not

permeate the organization as a legitimate ‘expense’, such as environmental degradation from factory pollution. Indeed, following Hines, systemic risk in the banking sector can be imagined as a kind of pollution which the large banking ‘factories’ produced and externalised, and which was invisible in the prevailing accounting and risk system - until it became too great to contain and overflowed the limits of these systems.

Because contemporary accounting and its entity logics are highly institutionalised, they are hard to challenge and this gives financial accounting as it is now practiced an almost invisible power: “we [accountants]create a picture of an organization…and on the basis of that picture….people think and act. And by responding to that picture of reality, they make it so” (Hines, 1988, p. 257). In other words, accounting constructs a picture of organizational reality which is institutionally demanded and reinforces actions in the name of that reality. Even seemingly technical financial accounting controversies, like the problem of group accounting discussed above, can also be read as fundamental controversies about nature of the enterprise and its boundaries.

For Hines, in traditional accounting all inputs to an enterprise must have a ‘cost’. This means that externalized, unaccounted-for pollution can only become an accounting cost if a liability is created for it, that is if the external event of pollution can be made internal to the organization. Or, in other words, the boundary of the organization must be shifted to recognise the pollution. However, from Hines’ point of view, accounting and accountants are not themselves the key agents of this boundary construction. They simply reflect and reproduce, and do not challenge, the institutionalised ontology of the organization. This means that the entity concepts

discussed above are themselves the result of accumulated social choice and accounting simply reproduces this choice. For this reason, Hines argues, somewhat against the more constructivist reading developed earlier, that cultural and institutional change can only come before accounting change, that is: “when people see ‘pollution’ as part of the organization’ (p.255).

Financial accounting and the corporate report in which it is embedded are never static There are many examples of financial accounting changing to accommodate new concerns and values created elsewhere, for example in responding to new environmental and social liabilities for organizations created by the law. There are also many disclosures that companies now make, under the general heading of ‘corporate social responsibility’, that lean towards a social entity accounting concept. Yet, critical accountants like Hines, are doubtful that these initiatives have really changed the dominant accounting picture of the organization and its boundaries. Over time, financial accounting has been receptive and creative in the face of social pressures for more representation of the social exterior, provided that these internalised accounting elements have a degree of measurability and auditability. However, Hines reminds us that there is a big difference between making an existing organizational boundary more permeable to its environment and recognising in accounting terms a wider range of possible effects of its activities, and changing the entity concept itself. The latter would require a major conceptual and institutional shift in the underlying concept of the entity, and this would require the creation of a new institutional reality of the kind that the UK company law review in the early 2000s decided not to embrace.

In summary, efforts to make accounting recognise and internalise social costs and effects reveal how the boundedness of the organization as enacted by an accounting system is a deeply embedded societal value choice. Despite extensive critique and pressures to bring more of society into financial accounting, and even some success at the edges in doing this, the dominant accounting entity concept itself is largely unchanged and de-politicised, not least for public organizations with explicit social purposes, such as charities, whose financial accounts strongly resemble those of private companies. For Hines and others like her, this shows that financial accounting and its entity assumptions serve a hegemonic purpose in supporting the 'interests of capital' and that other values and other forms of social organization would result in different accountings for different costs by different kinds of entity. Indeed, efforts to bring more of society into the realm of financial accounting have failed to shift the dominant entity concept. This reveals how financial accounting is also active in keeping society out as we now consider.

KEEPING SOCIETY OUT: ACCOUNTING AND ECONOMIZATION

The discussion so far has explored the role of financial accounting in shaping and reproducing the organizational boundaries of organizations as entities with a primary economic purpose. Here, as discussed in the previous section, the policy problem implicit in Hines' (1988) analysis has been one of accounting (and the law) making such organizations more permeable to non-economic values or at least, in the case of sustainability, to 'longer term' conceptions of the economic which align with other social values. But in the setting of public and not-for-profit sectors, where organizations are not primarily driven by economic values and exist for one or more

social purposes, the role of accounting has been the very opposite of bringing society back in. Rather, than making accounting more receptive to socially significant externalities, accounting in this setting is used as an instrument to make public organizations more economically purposeful. In short, accounting has been actively deployed as a change agent to construct organizations as economic entities and to re-define their boundaries in such terms.

This change process has been at the heart of the heart of neoliberal reforms to public administration in many countries over the last three decades – the so-called 'new public management' (Hood, 1995). Such reforms have been multi-faceted and complex but in essence have promoted private and market sector governance disciplines in the different fields of public sector service provision. Thus, there has been a growth of devices like outsourcing and contracting, outright privatisation, and risk-sharing via public private partnerships (Froud, 2003; Roberts, 2011). Furthermore, public sector workers have been subject to more stringent definitions and monitoring of performance in the name of key reform values, such as improved efficiency.

As an example of these changes, Kurunmäki's (1999) study of reforms to the Finnish medical system in the 1980s shows how there was a transition from an administrative to a more managerial culture premised on critiques of waste and inefficiency. The result was a shift from a centralised resource allocation model to a market-based system of allocation of finance via explicit contracts. This in turn required the development and transplantation of private sector tools of performance measurement to assess the performance of medical professionals. Financial accounting was deeply

implicated in this reform process, which involved the expansion of private sector style financial controls into areas where they had been previously absent. As in other parts of the public sector, the policy aspiration was that better accounting for the costs of medical treatment would allow political and public decision makers to use financial accounting to evaluate the financial strength of 'units' and 'sub-units' such as hospitals and their departments.

While these changes brought new possibilities for monitoring and evaluating performance they also created a 'potential discrepancy between…political decision makers and…medical professionals concerning the definition of an appropriate accounting entity in the health care field.' (Kurunmäki, 1999, p. 225). Medical professionals took a broader view of their accountability – it was to society at large in the form of patients rather than to the hospital as an autonomous economic entity. Specifically, there was an observed 'contradiction between idea of the hospital as an accounting entity, and the perception of a society-wide accountability' (p.227). Physicians and policy narratives were more focused in a general sense on the external benefits arising beyond the boundaries of the hospital as a constituted entity. Medical professionals in Kurunmäki's analysis operated intuitively with a 'social entity' (Meyer, 1973) assumption about the hospital, and assumed connections between their interventions and social welfare more generally, even though these benefits could in many cases be measured only imperfectly. Their sense of the organizational boundary and of the reach of their responsibilities, was much wider than the organization as an economic entity.

Yet despite this professional narrative, claimed external social benefits were too vague to qualify for recognition in financial accounts. Permeability in financial accounting necessarily simplifies and reduces externalities to their measurable and and auditable proxies. Furthermore, the expanded significance accorded to the new emphasis on financial accounting and its implicit entity concept became self-fulfilling. Accounting was powerful not only in recording the hospital as an economic entity but also in performing it by bringing new organizational routines into being to reinforce it over time. Kurunmäki shows that despite being initially disputed, the new accounting led progressively to a 'refocusing of attention of medical professionals' (p.230) resulting in changes to patient treatment practices and a new consciousness of costs to the economic entity. Hospitals as economic entities became permeated by economic reasoning of a specific kind, facilitated by accounting, which displaced older frameworks of public health economics. As a side-effect of this shift, the period of change also saw the emergence of gaming strategies by hospitals seeking to maximise their performance in terms of various new accounting indicators (e.g. Bevan & Hood, 2006).

Like Hines, Kurunmäki argues that the way that accounting made hospitals and clinical departments into entities is 'deeply embedded in attempts to reconfigure fields of power.' (See also Arnold & Oakes, 1995). The deployment and expansion of financial accounting, and its underlying entity concept, is a form of *territorialisation*, namely the creation of spaces for economic calculation which demarcate and separate such spaces into discrete entities from one another and from their environments (Miller & Power, 2013). The power of accounting consists not only in defining the boundaries of discrete entities but also in shaping humans and organizations as actors

focused on a defined form of performance within a specific space or territory (Miller, 1992).

One further important consequence of the deployment of accounting to construct organizations as economic entities is that their success and failure also become articulated primarily in accounting terms. Notions of solvency and financial health indicated by various ratios are only possible if there is a balance sheet which is, in turn, only possible when forms of 'accrual' accounting are introduced (Miller& Power, 1995; Kurunmäki & Miller, 2013). But once created, it is logically and empirically possible that such entities can be described as failing or can 'fail' as entities, even though the unmeasured and unaccounted social benefits of their activities may, in a realist sense, greatly 'outweigh' the costs associated with the entity. For this reason, failure may not have the 'reality' that is usually attributed to it (Kurunmäki, Mennicken & Miller, in press). Equally, as the case of a Mid-Staffordshire National Health service Trust in the UK demonstrated, organizations can be succeeding in accounting terms when they are failing in underlying patient care (Francis, 2013).

The role of financial accounting in economic entity construction has been explored in other contexts, including prisons (e.g. Mennicken, 2013) and Museums (e.g. Barton, 2005), which are organizations whose historical purpose is grounded in bringing about social changes and benefits beyond the 'walls' of the organization. These settings are characterised by numerous performance indicators, some of which are intended to bring 'society back in' and capture valued externalities, thereby compensating for the financial accounting entity view of the organization. In the

setting of prisons, reoffending rates have come to be important non-financial measures. In the case of museums, school outreach measures and visitor numbers seek to capture contribution to the cultural health of the nation. These measures of external social benefit are always imperfect proxies for desired outcomes and must compete with the historically established legitimacy of entity-focused accounting measures of financial health. Accordingly, organizations may be characterised by different kinds of permeability, different nuances of openness and closure, at the same time.

These examples show how financial accounting is at the heart of an essential tension between the economic entity concept and the social entity concept. Furthermore, as increasing numbers of large private organizations also make non-financial social disclosures as part of their response to pressures to be more socially responsible – to be discussed in the next section – the distinction between public and private becomes blurred across more hybrid entity concepts. However, it would be wrong to suggest a convergence across public and private. Indeed, ironically, public sector organizations find themselves subject to more extreme forms of economization than their privatree sector counterparts. For example, UK hospitals were being constructed as economic entities as noted above at the same time as there was post-crisis recognition of the social importance of banks requiring public support because they are ‘too big to fail’. As Roberts (2011) puts it, the logic of market discipline has been applied in its most extreme form to organizations which are most remote from the market system e.g. hospitals and schools. At the same time, he argues that many ‘private’ sector arrangements such as large infrastructure projects have been exempt from this logic of discipline. Indeed, in addition to the banking system, private- public partnerships

intended to share risk between public and private providers of services, reveal that the public taxpayer is usually the risk bearer of last resort.

To summarise: in this section a further nuance of the society-entity tension in financial accounting has been explored. While critical accounting is broadly committed to an accounting entity concept which lets more of more society into the accounting for the enterprise, this section has explored how this critical perspective is also turned on its head: financial accounting and other techniques have been deployed to keep society out and to shape organizations as economic entities in a specific sense i.e as more inward-looking cost-conscious economic entities seeking continuous improvement in efficiency first, and social purposes second. From this point of view, financial accounting enables economic ideas to 'economize' organizations (Callon, 1998). Yet, society cannot be kept out so easily, and this brings us to the fourth problematic of financial accounting and the society-entity interface.

THE RESPONSIVE ORGANIZATION: ACCOUNTING, ACTORHOOD AND STAKEHOLDERS

The sense that the autonomous pure accounting entity concept is also an implicit actor-concept, has emerged from the discussions above, from group accounting to economization. However, rather than the rationally acting, autonomous organization being a construction of accounting as such, the arguments of Meyer and Jepperson (2000) and Meyer and Bromley (2013) suggest that it is a systemic feature of rationalization in modern societies, of which accounting is just a case. Modernity is characterised by the emergence of organizations which are increasingly attributed

with rational, autonomous, decision-making capability and are presumed to act purposefully in relation to their environments. By reproducing a distinctive form of culturally contingent autonomy – a bounded, responsible and acting organizational self, accounting is deeply implicated in this rationalization project (Samiolo, 2017). The accounting entity assumption is therefore not merely an enabling condition of possibility for organizational accounting. It also underwrites the construction of the organization as actor which must increasingly respond to the demands of society and for which society and its representatives have expectations.

Following this line of thought, the society-entity nexus can be interpreted in terms of the permeability of organizations to the interests of stakeholders as an actor class which represents society and can be defined by being entitled to demand accounts. From this point of view, accounting mediates and absorbs the demands of stakeholders. For example, Bromley and Sharkey's (2017) longitudinal analysis of US annual reports and accounts reveals the emergent character of organizational actorhood. They conceptualise annual reports as contingent expressions of changing conceptions of such actorhood in the organizational environment, not least in responding to the corporate social responsibility agenda as it has unfolded in recent decades. In this respect, at the same time as social entities are being constituted as economic actors via financial accounting as part of state reform programmes, seemingly economic entities are displaying forms of actorhood which speak to social responsibility in their annual reports and other disclosures.

We should not mistake such displays of actorhood at a field level for real change (Young, 2017). These displays are likely to be highly correlated with, and are

responses to, the institutional complexity created by different logics of performance – economic and social – and the need to be accountable to different audiences (Greenwood et al., 2011). Furthermore, powerful stakeholder groups are increasingly able to generate reputational risk for organizations and, in part, the growing cultural acceptability of social responsibility has changed the operating environment for many organizations. Thus, the society-entity boundary has become one in which organizations as autonomous actors experience, and must respond to, reputational and other risks. From this point of view the accounting entity in a world of stakeholders is also an entity-at- risk, permeable to demands and expectations from society and under continuous pressure to be responsive by making new risk and social responsibility disclosures.

Financial accounting cannot stop the 'outside coming in' (Power, 2007, chapter 5); it is not equipped to keep risk and society entirely out. In the core financial statements, societal concerns must pass a measurement hurdle to be included as costs or liabilities. But these concerns can nevertheless acquire visibility in other modes of quantitative and qualitative accounting disclosure within the wider annual report. Hence, under conditions of expanded risk awareness, the boundary of the organization has become wider and more permeable to society than the boundary of the financial accounting entity (Power, 2007; Hardy & Maguire, 2016).

In summary, financial accounting constitutes and is constituted by the fiction of the autonomous entity which is a capable and purposive actor. We can look back at the technical debate about group accounting, control and consolidation methods and suggest that what is fundamentally at stake is sustaining, via accounting, the fiction of

purposive control at the centre of a group, understood as an economic meta-entity. We should not say that these fictions are merely illusory since they are institutionalized and continuously reproduced. The source of their fictiveness does not lie in the accounting tricks and deceptions perpetrated by firms like Enron. It flows from a more general process of rationalization which is productive of ideas of good process, bounded entities and rational actors. Yet once responsible actorhood is increasingly attributed by society to organizations, they are of necessity more permeable to, and at risk from, society.

DISCUSSION AND CONCLUSIONS

The entity assumption is fundamental to the preparation of financial statements and performance reports. It has been argued that, despite the sociology of embeddedness, dis-embedding is a necessary feature of accounting as a social and institutional process. Furthermore, an entity concept and therefore a boundary between what is accounted for and what is not accounted for is a necessary condition for the possibility of coherent financial accounting. Even the social entity concept requires a boundary to be drawn between those social effects of organizations which are accounted for and those which are not. So, new forms of accounting to capture new objects, such as carbon emissions, require entity and boundary assumptions just as much as financial accounting does – but the entity may be different (Hopwood, 2009). All accounting requires some reduction and simplification to support its role in commensurating across different organizational entities (Espeland & Stevens, 1998).

It has also been argued that any specific accounting entity assumption may be challenged, for example by the growth of networking and outsourcing arrangements in which the boundaries of control and responsibility overflow accounting entities and their accounts. This world of invisible relationships, radical organizational permeability and fluid boundaries poses continuous challenges to traditional financial accounting. However, even in a world of extensive outsourcing across multiple organizations with critical strategic interdependencies, there are likely to be underlying contractual relations between distinct legal and accounting entities. It can therefore be suggested that the institutional fiction of the accounting entity and the actor construct which it supports may be even more necessary as an underpinning to a world of alliances and blurred economic dependencies.

Nothwithstanding the necessity of the entity concept for financial accounting, we began by showing that there was not one but several possible such concepts with somewhat different logics and implications. In most countries, the accounting entity is a hybrid, mainly of proprietorial and autonomous actor logics. The essay then explored four indicative problematics which exhibit the essential tensions between these different entity concepts, their values and the different boundaries they draw between the entity and not-entity. Table 1 provides a summary of the argument.

PUT TABLE 1 HERE

First, taking the setting of technical group accounting and the problem of accounting for control, we discussed how the boundary between what is inside and outside of the group entity is a technical construction of accounting rules rather than a natural

demarcation of any kind. The group as an accounting entity conceptualises the outside to which it is permeable in terms of a non-controlled third-party interest. Second, drawing on Hines (1988) as an exemplar of critical accounting, we argued that the accounting entity concept implicates an ecological politics of organizational boundaries. Accounting constructs and reproduces an institutionalized organizational reality in which some costs, such as environmental degradation, are placed outside the accounts and therefore outside the organization. This means that the entity concept and its boundaries are a social value choice. The critical accounting project is to make conventional accounting boundaries more permeable to these costs and to internalise them. Third, the argument considered the inverse of this problem of internalising externalities in the setting of public sector organizations with public purposes. Here the role of accounting has been to actively reshape organizational boundaries by making organizations conform to models of discrete economic and contractually competent autonomous entities capable of both performing and failing. The external benefits of these entities may be captured by metrics for impact, but the financial accounts construct them independently as economic entities which may be more or less cost-efficient. Finally, drawing on organizational sociology, the role of accounting in constructing the organization as a rational actor has emerge from wider societal rationalization and the increased organizational salience of risk, resulting in organizations which must be increasingly responsive to the demands of society via varieties of stakeholders. The accounting entity is permeable to these demands in terms of the reputational and legal risk that they pose.

The arguments above are imperfect and have been stylized considerably. The four settings and their problematics need much more elaboration. For example, as noted

above, financial accounting consists of core statements (balance sheets, income statements, cash flow statements) and notes to the financial statements. But there may also be other disclosures within the annual report, such as social impact metrics. The latter may reflect more of a social entity concept than the financial statements. Indeed, the modern corporate annual report contains plural entity concepts and their forms of organizational permeability. So the argument in this essay has greatly simplified the terrain of corporate reporting. It has also not developed some possible, perhaps even obvious, theoretical aspects of the analysis, such as Luhmann's systems-theoretic perspective. His work is no doubt directly relevant to issues of boundaries and permeability and could have been invoked at various junctures.

However, notwithstanding these limitations, the essay has tried to show how accounting must be at the heart of any debate about organizational permeability. The accounting entity concept, which is often invisible and untheorized, plays a critical role in shaping particular modes of accounting transparency and disclosure. Financial accounting makes the organization permeable and auditable, but in very specific ways and in relation to specific values which can be contested. The four problematics show how the boundary between the entity and society as 'not-entity' can be imagined in very different ways, from the technicalities of group accounting to the cultural myth of the organization as rational actor. And, even in the setting of technical group accounting rules, society has a stake which can become suddenly visible. Various socially costly frauds have involved the hiding of risk in debt instruments which in accounting terms are "off-balance sheet" i.e. outside the entity accounting system. So the question of entities, boundaries and permeability is one in which accounting continuously tries to represent the organization-society relationship.

We take this for granted most of the time and it is unproblematised. But the inherent gap between organizational accounting and organizing as a process is ever present, and the excluded outside will continuously overflow institutionalised accountings, creating pressures for reform to financial accounting. It should be clear that these pressures do not simply concern technical issues of measurement. They implicate the essentially contestable nature of organizational entities, boundaries and permeability which will always be present in any new accounting form.

To conclude: there is no ‘natural’ condition of organizational permeability. We have not moved from a world of less permeable to more permeable organizations. Rather, there is a permeability/closure nexus which is continuously changing and developing. Financial accounting is at the heart of this process. It is one way, but a very important and institutionally powerful way, by which organizations are both open and closed, bounded and permeable, to their social environments.

ACKNOWLEDGEMENTS

The author is grateful to the editors and to an anonymous reviewer for comments on an earlier draft of this essay.

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Accounting entity boundary	**Problematization**	**Form of entity permeability**
Group – Non-Group	Technical accounting and the problem of control	Recognise non-controlling interests
Society-entity	Critical accounting and the recognition of externalities	Internalization of external costs
Entity-society	Accounting expansion and the economization of social entities	Externalization of external costs
Actor - Stakeholder	Organizational actorhood and accounting	Responsiveness to reputational risk

Table 1: An overview of four boundary-permeability problematics in accounting