

Accounting as a means to legitimacy: the case of internally generated intangibles

Accounting as
a means to
legitimacy

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Abstract

Purpose – The purpose of this study is to identify the norms that underlie and condition the decisions made by preparers of financial reports.

Design/methodology/approach – This interview-based study illustrates how financial report preparers engage in behaviors linked to the perception of recognition and measurement of internally generated intangible assets by important stakeholders. All of the companies included in the study adhere to International Financial Reporting Standards when creating their consolidated financial statements. The participants selected for the study are involved in accounting decisions related to research and development in accordance with International Accounting Standard (IAS) 38.

Findings – The authors identify the normative assumptions underlying the recognition and measurement of internally generated intangibles, which are based on concerns of consistency, credibility and reasonableness. The authors find that the normative basis for legitimacy in financial accounting is primarily related to cognitive legitimacy and is not of a moral or pragmatic nature.

Originality/value – The study reveals that recognition and measurement of internally generated intangibles in financial accounting relate to legitimacy. The authors identify specific norms that form the basis of this legitimacy, namely, consistency, credibility and reasonableness. These identified norms serve as constraints, mitigating the risk of judgment misuse within the IAS 38 framework for earnings management.

Keywords IAS 38, Intangibles, Legitimacy, Norms, R&D, Recognition, Measurement

Paper type Research paper

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1. Introduction

While the body of literature on the application of International Financial Reporting Standards (IFRS) is extensive, less is known about the actual process of preparing financial reports and how it impacts their presentation. In the words of Amel-Zadeh *et al.* (2019, p. 2), “little is known about the people who create disclosures [...] and how they contribute to the disclosure process.” Consequently, our understanding of the organizational context and the various factors influencing the reporting process, as well as shaping practices, remains limited (Oberwallner *et al.*, 2021). This knowledge gap is significant because the presentation of disclosures reflects the characteristics of the report preparers rather than the firm itself (Amel-Zadeh *et al.*, 2019). However, qualitative research on financial reporting practices is sparse (for exceptions, see Mazzi *et al.*, 2022; Oberwallner *et al.*, 2021).

Research indicates that investment in research and development (R&D) is of paramount importance, and it is evident that companies’ performance and value creation are strongly linked to intangible resources. However, the asset recognition rules outlined in International Accounting Standard 38 (IAS 38) (issued in 1998) do not seem to align with current needs (Lev, 2019; Mazzi *et al.*, 2022). According to IAS 38, paragraph 57, development costs associated with internally generated intangible assets can only be capitalized if six criteria are met (see Table 1).

While the requirements set by IAS 38 seem strict, previous research demonstrates that “compliance with this rule varies considerably because there is a high level of flexibility and managerial discretion in the IFRS development capitalization rule” (Lev, 2019, p. 713). One issue perceived in the application of IAS 38 is that due to the high capitalization threshold, investments in internally generated intangibles are often expensed in the income statement and aggregated with current expenses. Consequently, there is a mismatch between revenues and costs (Barker *et al.*, 2022). Furthermore, the judgment-based nature of IAS 38 introduces managerial opportunistic behavior and earnings management in the capitalization of R&D projects. For instance, Dinh *et al.* (2016) demonstrated that capitalization of R&D projects is influenced by managers’ pursuit of benchmark beating or when growth possibilities are limited. Lev (2019) highlighted that the indiscriminate expensing of internally generated intangibles undermines the value relevance of accounting information. When development costs are capitalized without solid probabilities of future economic benefits due to earnings management, it leads to misleading information.

IAS 38 para. 57	An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:
(a)	The technical feasibility of completing the intangible asset so that it will be available for use or sale
(b)	Its intention to complete the intangible asset and use or sell it
(c)	Its ability to use or sell the intangible asset
(d)	How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset
(e)	The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset
(f)	Its ability to measure reliably the expenditure attributable to the intangible asset during its development

Table 1.
IAS 38 paragraph 57 Source: Table created by authors based on the wording of IAS 38, para. 57

Despite the standard's objective to provide decision-useful information to users, research suggests that investors do not view the capitalization of internally generated intangibles as a signal of future value creation (Mazzi *et al.*, 2022). Lev (2018) asserted that the "deficient accounting treatment of intangibles" (expense of internally generated intangibles while acquired intangibles of the same nature are capitalized) diminishes the information's usefulness.

Given the discretionary nature of accounting practices for internally generated intangibles and the potential for managerial opportunistic behavior and earnings management, a fundamental question arises: What is the normative basis of the decisions made by preparers of financial reports when accounting for internally generated intangibles?

In particular, we seek to understand the norms that impact these decision-making processes. From a theoretical perspective, the normative basis that we will identify relates to legitimacy, understood as a resource aspired for by the preparers, that is gained through adhering to societal norms and expectations (see, e.g. Aerts and Cormier, 2009; Cho and Patten, 2007; Deegan, 2002; Milne and Patten, 2002; O'Donovan, 2002; O'Dwyer, 2002). We argue that the discretionary activity of the preparers can be understood through the lens of legitimacy relating to how they want the financial accounts to be seen and perceived by important others.

Our findings show that the legitimacy of a company's recognition and measurement of internally generated intangibles tends to be guided by three underlying norms: *consistency*, *credibility* and *reasonableness*. *Consistency* compels preparers to act prudently in managing the company's intangible assets to maintain coherence and structure, making decisions that ensure the financial reports remain coherent over time. *Credibility* is concerned with how external parties perceive the company, urging preparers to make decisions that are perceived as credible by external stakeholders, balancing between recognizing too many intangibles, which negatively impacts credibility, and not recognizing them, which would be misleading. *Reasonableness* is about making decisions based on sound judgment and avoiding extreme or unreasonable conclusions. Given the crucial role of financial reports in establishing and upholding legitimacy with stakeholders, any departure from a reasonable reporting can cast doubts on a company's legitimacy. The norm of reasonableness encourages preparers to exercise informed judgment, ensuring that the information within financial reports aligns with the company's business and market context, rendering it reasonable, plausible and congruent. We argue that these identified norms act as constraining forces, curbing the potential misuse of judgment within the IAS 38 framework for earnings management.

The remainder of the article is structured as follows. First, the article defines and discusses the concept of legitimacy, the theoretical tool of the article, followed by a section that discusses the recognition and measurement of internally generated intangible assets as per IAS 38. Then, the research design and method are described. Thereafter, the article identifies the norms guiding the recognition and measurement of internally generated intangibles. In a concluding section, we relate these norms to legitimation and discuss the results, how our findings contribute to existing literature, and reflect on limitations and further research.

2. Legitimation through financial accounting

Over the years, many scholars have shown interest in examining the impact of legitimacy concerns on financial accounting practices. Analytically, the concept of legitimacy is typically defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995, p. 574). From an organizational standpoint, being

perceived as legitimate is crucial because it provides access to resources and markets, as well as a degree of operational autonomy that is less likely to be questioned (Deephouse and Suchman, 2008).

Legitimacy depends on an organization's ability to conform to the social expectations of the external world (Deegan, 2019; Maroun, 2018). Failures to comply with behavioral and performance norms have proven to be a serious threat to the legitimacy of organizations (Bebbington *et al.*, 2008).

Legitimacy, in addition, manifests in various forms depending on different underlying assumptions and prerequisites. A widely accepted framework, drawing from Suchman's (1995) definitions and also used in the accounting literature (e.g. Georgiou and Jack, 2011; van Zijl and Maroun, 2017), distinguishes between *moral*, *pragmatic* and *cognitive legitimacy*. Moral legitimacy involves the social collective legitimizing a company, its structures or operations based on its perceived correspondence with societal norms. Pragmatic legitimacy, on the other hand, is based on the perception of the social collective that the company, its structures or operations are beneficial in a more self-interested aspect. Finally, cognitive legitimacy is founded on the understandability and meaningfulness of the company; if it acts in accordance with the cognitive frames of the legitimating collective, it gains cognitive legitimacy.

Accounting itself has been recognized as an institution that plays a legitimizing role by connecting social values to economic actions (Richardson, 1987). Legitimacy also relates to financial reporting, as companies must provide certain accounting information or forms of accounting to the outside world to gain, maintain or retain legitimacy (Deegan, 2002; Dowling and Pfeffer, 1975; Stanton and Stanton, 2002). These concerns surrounding legitimacy can, in turn, result in differences in the quantity, quality and nature of accounting information (see, e.g. Cho *et al.*, 2015; Cho and Patten, 2007; Clarkson *et al.*, 2008; Patten, 2002).

One strand of the literature claims that companies use accounting information strategically to shape the perceptions of external stakeholders (Cho *et al.*, 2009). This strategic use serves various purposes, such as mitigating negative exposure by concealing certain activities or poor performance (Cho *et al.*, 2009, 2010). On the other hand, companies may leverage accounting information to highlight positive corporate performance, initiatives or activities, thereby demonstrating adherence to societal norms (Cho *et al.*, 2015; Deegan, 2002). Research indicates that extensive efforts to establish legitimacy and dimensions of legitimacy are also pertinent to the development of accounting standards like IFRS (Pelger and Spieß, 2017; Richardson and Eberlein, 2011).

Financial accounting practices have been recognized as contributing to legitimacy (Cormier and Gordon, 2001; Deegan *et al.*, 2000; Stanton and Stanton, 2002; Suchman, 1995). Legitimation, as a construct involving a primarily external audience, implies a process where important others see companies as accountable (Branco and Rodrigues, 2008; Nikolaeva and Bicho, 2011). Accounting, in general, and financial accounting practices, in particular, serve as visible means of addressing such accountability concerns.

Another aspect of the legitimacy of financial accounting practices pertains to how companies strive to attain legitimacy. Companies may demonstrate compliance with established standards. Evidence suggests that adhering to IFRS standards enhances a company's legitimacy in the eyes of stakeholders (van Zijl and Maroun, 2017). While not explicitly referring to legitimacy, Nobes and Stadler (2015) highlight the aspirations of preparers to adhere to the qualitative characteristics outlined in the IASB conceptual framework (see IASB, 2018), which include relevance, faithful representation, comparability, understandability and transparency (though not explicitly stated in the framework).

Tentatively, the normative foundation set by the IASB could serve as a benchmark for preparers seeking legitimacy.

Distinct and established methodologies and procedures are also important to follow to be perceived as legitimate. “With stakeholders unable to observe directly the financial reporting process, statements on compliance with the ‘sound practices’ (R6; R9) described by IFRS 10 and IFRS 12 secure legitimacy for the reporting entity by relying on generally accepted confidence in a clearly defined, well-developed, cognitive base” (Maroun and van Zijl, 2016, p. 229f). Accounting practices or principles relating to measurements, such as fair value or historical cost, have also been discussed in relation to their acceptance and legitimacy over time (e.g. Georgiou and Jack, 2011), as well as the legitimating capacity and need of the auditing profession related to “irregular” auditing practices (Herrbach, 2005). In addition, standard-setting organizations, such as the IASB, have attempted to legitimize themselves and their standards. For instance, engaging in public agenda consultations to promote their organization and standards has been identified as a means to obtain legitimacy (Pelger and Spieß, 2017; see also Richardson and Eberlein, 2011).

Furthermore, regulated financial accounting presents an avenue for *preparers* in terms of the generation of accounting numbers and the composition of reports. Related to legitimacy, the way in which external (and potentially internal) stakeholders perceive the accounting decisions made by preparers holds significant importance. This holds true even for mandatory financial reporting requirements, particularly when there is room for interpretation and discretionary actions. The rationale behind this is that even though reporting is required and may be detailed in standards, there is still some autonomy in deciding which numbers or texts should be included in reports and how the preparation process should be conducted.

One aspect of this autonomy is how the preparation process is structured and coordinated to gain acceptance, as Hartmann (2022) notes, for instance, through codification, depersonalization and proceduralization. Codification sets standard requirements and converts them into organizational guidelines. Depersonalization transforms these rules into calculation tools, consolidating information into single values. These tools, known as inscriptive devices, influence what is allowed or denied. Proceduralization handles input integration, enhancing the overall autonomy framework. Another aspect relates to the content, texts and figures in reports and their ability to persuade key stakeholders. Examples of this can be found in the impression management literature, such as Martins *et al.* (2019). Companies tend to display self-serving biases in their disclosures when actual performance diverges from desired benchmarks and when explaining the underlying causality of financial performance. Aerts and Cheng (2012), for example, point to assertive and defensive causal bias, implying (respectively) the relative tendencies to explain positive effects more from internal than external causes and negative effects more from external rather than internal causes. In such cases, companies use concealments and attributions in their financial reports to present their performance in a more favorable light (Cho *et al.*, 2010; Deegan, 2002, 2019; Leung *et al.*, 2015). This aspect holds considerable relevance for the application of IFRS standards.

For instance, IAS 38 mandates companies to capitalize internally generated intangible assets provided they meet specific criteria (further elucidated in Section 3). However, given the subjective nature of these criteria, preparers wield a degree of discretion in their application. Companies in pursuit of legitimacy may be inclined to capitalize intangible assets, even if they marginally satisfy the criteria. The rationale behind this lies in the potential to present the company as more innovative and valuable to investors, enhancing its legitimacy. Preparers may be motivated to make decisions that are more persuasive to

key stakeholders, even at the expense of fidelity to the most accurate representation of the company's financial standing and performance. Other studies tend to focus on, for example, rhetorical strategies used by preparers (see, e.g. [Aerts, 2005](#); [Aerts and Yan, 2017](#); [Cho et al., 2010](#)) rather than examining conformity to overarching normative understandings that enable the company to obtain legitimacy. [Ogden and Clarke \(2005\)](#) demonstrate how newly privatized water public limited companies position themselves as customer-focused in line with their new status as private companies.

Beneath these circumstances, the underlying assumption is that preparers engage in strategic planning regarding how the numbers will be perceived by significant stakeholders ([Deegan et al., 2000](#); [Ogden and Clarke, 2005](#); [Stanton and Stanton, 2002](#)). Even if there is no certain strategic course of action among preparers, their decisions can be assumed to be conditioned by concerns about how to be perceived.

In the following section, we will delve deeper into the actual accounting practice of recognizing and measuring internally generated intangibles in accordance with the IAS 38 standard. The recognition and measurement of such assets are inherently complex issues and, to some extent, subjective in terms of judgments during the preparation process ([EFRAG, 2021](#)). These judgments are based on uncertain calculations and relative reliability ([Huikku et al., 2017](#)). This will serve as an example of preparers acting out of concern for legitimacy. In fact, it has been stated that when valuing internally generated intangibles, companies, auditors and analysts must make efforts to enhance their credibility in the eyes of others ([García-Ayuso, 2003](#)). By conducting interviews with preparers, we have identified an underlying normative basis for recognition and measurement from their perspective. This reflects their understanding of how legitimacy is sought through this particular accounting practice.

3. Accounting for internally generated intangibles

The accounting treatment of intangible assets plays a significant role in financial reporting, as they often represent valuable resources for entities across various industries. IAS 38 provides guidance on the recognition and measurement of intangible assets. According to IAS 38 (para. 8), an intangible asset is defined as “an identifiable non-monetary asset without physical substance,” forming the foundation for identifying a diverse range of intangible resources, including scientific knowledge, intellectual property and market expertise. While these assets encompass items such as patents, copyrights and customer relationships (para. 9), not all qualify as intangible assets; they must meet criteria including identifiability and control over future economic benefits (paras. 11–17). Identifiability may arise through separability or contractual rights, while control is typically based on legal enforceability. Future economic benefits from intangible assets can include revenue, cost savings or other advantages. Correct classification is vital for accurate financial reporting and accounting treatment, distinguishing intangible assets from other expenditures or goodwill in business combinations.

The standard not only outlines the recognition and measurement criteria for intangible assets but also draws a clear demarcation between acquired and internally generated intangibles. IAS 38 establishes that acquired intangible assets, such as those acquired through business combinations (para. 25) or separate acquisitions (para. 33), are to be recognized in the financial statements when specific criteria are met. Essentially, the criteria hinge on the probability of future economic benefits flowing to the entity and the reliable measurement of the asset's cost. Acquired intangibles inherently possess a transactional history that makes the determination of cost relatively straightforward. The recognition of

acquired intangibles is generally less contentious, as the assets are often acquired in an arm's length transaction, with a clear purchase price.

In stark contrast, internally generated intangibles undergo a distinctly different journey within the accounting framework. IAS 38 (para. 57, see [Table 1](#)) stipulates that internally generated intangible assets shall be recognized as assets if, and only if, specific conditions are met. This recognition criterion necessitates stringent proof of an asset's existence, along with the ability to reliably measure its cost, a process that can be considerably more intricate when compared to acquired intangibles.

The differentiation between these two categories of intangible assets acknowledges the inherent complexities associated with internally generated intangibles, particularly the challenge of demonstrating their existence and reliable measurement. Internally generated intangibles often emerge from a spectrum of activities, ranging from R&D to innovation and creative processes. These assets may evolve organically within the entity, making it more challenging to pinpoint their inception and evaluate their worth accurately.

3.1 Recognition and measurement under IAS 38

Recognition of internally generated intangible assets depends on meeting specific criteria outlined in IAS 38. Paragraph 51 elucidates the challenges associated with such assets, requiring adherence to the definition of an intangible asset and the necessity of a reliable measurement of cost. It is essential to highlight that expenditures related to R&D are treated differently compared to other types of expenses or financial activities. IAS 38 (para. 52) distinguishes between two phases of intangible asset development: the research phase and the development phase. The standard adopts a distinctive approach for each phase, recognizing the inherent uncertainties and challenges associated with internally generated intangibles, particularly in the research phase. The standard provides the following requirement regarding the research phase:

In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is recognised as an expense when it is incurred. (IAS 38, para. 55)

If the assessment positions the project within the research phase, the company has no choice but to expense the expenditure. However, once the project enters the development phase, the standard allows for recognition:

In the development phase of an internal project, an entity can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits. This is because the development phase of a project is further advanced than the research phase. (IAS 38, para. 58)

However, for a project to be considered within the development phase, the company must demonstrate six different criteria. If these criteria can be met, the project expenditure incurred from that date onward should be recognized as an intangible asset. [Table 1](#) presents these criteria.

Measurement after recognition in accounting, as outlined in IAS 38 (paras. 72–87), presents a critical decision point for entities in managing their intangible assets. The standard offers two distinct approaches: the cost model (para. 74) and the revaluation model (paras. 75–87). Under the cost model, intangible assets are carried on the balance sheet at their historical cost, subject to accumulated amortization and impairment losses. In contrast, the revaluation model allows for the periodic revaluation of intangible assets to their fair value, provided there exists an active market for these assets. The key distinction between

these models lies in the treatment of asset values. While the cost model maintains assets at their original historical cost, the revaluation model facilitates periodic adjustments to reflect their current market values. This flexibility, however, is contingent upon the availability of an active market. The choice between these models influences financial reporting outcomes, impacting the balance sheet values and income recognition patterns for intangible assets. Consequently, it underscores the significance of assessing the presence of active markets and the potential implications on financial statements, emphasizing the need for careful consideration.

According to IAS 38 (para. 89), internally generated intangible assets with finite useful lives are subject to amortization. The amortization is to be carried out on a systematic basis over the useful life of the asset. Once the expenditure has been recognized, the asset should be amortized in accordance with the accruals concept over its finite life (para. 97). Amortization must only begin when commercial production starts, ensuring that income and expenditure are matched to the relevant period. In addition, internally generated intangible assets with finite useful lives are evaluated for impairment when there is an indication that the asset's value has been reduced (para. 104).

If a company has determined that the useful life of the internally generated intangible asset is indefinite, based on the factors listed in IAS 38 (para. 90), the asset is not subject to amortization. Instead, it must be assessed for impairment on a regular basis (para. 108).

3.2 Challenges under IAS 38

IAS 38 provides guidelines to address the complexities surrounding internally generated intangible assets. Prior to adopting IFRS, there were considerable variations in the accounting treatment of internally generated intangible assets among countries. Previous studies have documented that internally generated intangibles reported under different accounting regimes have different levels of relevance and reliability (Gong and Wang, 2016; Healy *et al.*, 2002). In contrast, IAS 38 mandates the recognition of development costs when the six criteria (IAS 38, para. 57) are met, while research costs must be immediately expensed, thus reducing the discretion involved in R&D recognition (Dinh *et al.*, 2016).

Arguably, there still exists a degree of freedom in the recognition and measurement of intangible assets generated internally. The internal generation of intangibles involves R&D, and from an accounting perspective, judgment is required regarding when such expenditures should be recognized. The criteria specified in IAS 38 mandate managers to use proprietary information and make subjective judgments (Kreß *et al.*, 2019; Mazzi *et al.*, 2019). It can be argued that managers are the most suitable individuals to make judgments regarding technical and commercial viability and profitability. However, the uncertain nature and high levels of estimation required in forecasting future income regarding these types of projects provide ample room for subjective judgments, which can be manipulated by managers to limit their discretion.

When managers make judgments regarding probable future economic benefits, market participants are likely to assess the company's future earnings potential based on its financial reports, including the accounting treatment of its internally generated intangibles. Therefore, by recognizing development expenditure, managers are conveying their opinions about its expected value. Conversely, they would communicate a lack of capacity to generate future economic benefit by expensing the expenditure.

Consequently, the complexity of information related to internally generated intangibles increases the uncertainty during both information production and forecasting. For example, recognition of development expenditures poses challenges for both preparers and analysts in distinguishing between recognized development costs and expensed R&D costs (Dinh *et al.*, 2015).

According to EFRAG (2021), the measurement at cost is problematic because it is difficult to identify and allocate internal costs. Assessing future economic benefits at the time when costs are incurred and distinguishing costs related to a specific asset from costs related to the business as a whole involve a high degree of uncertainty.

3.3 Controversy surrounding internally generated intangibles

The accounting treatment of internally generated intangibles, specifically R&D expenditures, has been extensively researched in numerous papers. R&D has been a prominent feature in the literature and remains a controversial issue among practitioners and academics. Some scholars argue that R&D expenditures should be recognized as investments (e.g. Lev, 2008; Lev and Sougiannis, 1996), as they are long-lived assets that impact future profits (e.g. Ballester *et al.*, 2003; Sougiannis, 1994). Others argue that expensing is preferable due to the benefits of consistency and comparability and the uncertainty of any future economic benefits (e.g. Kothari *et al.*, 2002; Skinner, 2008).

The research landscape concerning the accounting treatment of internally generated intangibles has predominantly been characterized by archival market-based studies. In the context of IAS 38, these studies are either centered around the signaling effect of recognizing development costs (value relevance) or the use of recognition as an earnings management tool. Regarding the value relevance of recognizing internally generated intangibles, researchers find that by recognizing development costs, companies are signaling positive signals on future economic benefits (Healy *et al.*, 2002; Lev, 2019). There is, however, a lack of studies that explore the reasoning of users or preparers of financial reports. One notable exception, offering a user perspective, is the work conducted by Mazzi *et al.* (2022). It is important to highlight the substantial temporal gap between Mazzi *et al.*'s recent study and the preceding research studies (e.g. Entwistle, 1999; Goodacre and Mcgrath, 1997), all of which explored the perspectives of users and preparers on the accounting treatment of internally generated intangibles.

Dinh *et al.* (2016) found that, although recognition of development costs is associated with earnings management, analysts seem to be able to distinguish between earnings management behavior and more truthful signaling. When talking to investors, however, Mazzi *et al.* (2022) found mixed views on the signaling effect of recognized development costs. Mazzi *et al.* (2022, p. 2) explained that this is "attributed to their widely held criticisms regarding the lack of clarity and guidance and resultant subjectivity of the conditions/criteria in IAS 38, which can be vulnerable to managerial manipulation."

In conclusion, the literature has presented arguments for both recognizing R&D as investments and expensing them. While numerous archival market-based studies have been conducted on the topic, there is a lack of research exploring the reasoning of users and preparers of financial reports. Recent studies have focused on the signaling effect of recognizing development costs, with researchers finding that recognition can signal positive signals on future economic benefits. However, there are concerns about the subjectivity of criteria in the IAS 38 standard and the potential for managerial manipulation. These concerns are not merely technical but also touch upon the legitimacy of financial reporting practices. The discretion provided by accounting standards can result in varying interpretations and, consequently, discrepancies in how companies' financial reports are formulated and perceived by external (and internal) stakeholders.

The following section discusses the research design, data collection methods and data analysis techniques used to investigate the challenges faced by companies when accounting for internally generated intangible assets under IAS 38.

4. Methodology

4.1 Research design

The purpose of this study is to identify the norms that underlie and condition the decisions made by preparers of financial reports. Given the complexity surrounding IAS 38, internally generated intangibles provide an interesting and relevant example to study to demonstrate how financial accounting is used to gain legitimacy. It is, therefore, natural to focus on preparers within companies who are deeply engaged in decisions regarding the recognition of intangibles (Lantto, 2022). Examining the recognition and measurement of internally generated intangibles as an example of when preparers have relative freedom in providing accounts provides an opportunity to understand how this is done and what normative considerations it is based on.

To access the reasoning behind decisions regarding the recognition and measurement of internally generated intangibles, this study relies on interviews with preparers who must consider in detail and propose what will be published in the consolidated financial reports. The assumption is that the norms' underlying behaviors can be found within the reasoning of preparers. Respondents in the study were selected based on two main criteria. First, they had to be part of a company that applies IFRS. All the selected companies were listed on a stock exchange in Sweden and were required to apply IASs in their consolidated financial statements. There are no specific requirements in Swedish accounting law other than IAS 38. Swedish companies were selected for practical reasons due to accessibility. Although there are no particular local requirements or recommendations affecting the application of the international standard, the importance of the local context for interpreting accounting standards is acknowledged (e.g. Yamani and Almasarwah, 2019; Zeff, 2007). Despite this, the example used illustrates underlying legitimacy concerns within financial accounting. Second, the respondents had to be key individuals with insights into intangible accounting decisions and judgments of the company. The selected respondents are mainly group accounting managers and chief financial officers who are responsible for relevant decisions regarding recognition and measurement.

4.2 Data collection

The study presented in this article is part of a larger project that examines accounting practices for intangible assets (see Lundh, 2020). The data collection process for this study consisted of two rounds. The first round involved conducting 20 interviews with respondents from 20 different companies. The second round comprised four interviews, which aimed to revisit the topic while also providing additional and more focused empirical material. Between 2011 and 2018, a total of 24 interviews were conducted, involving 27 respondents from 23 different companies (see Table 2 for a list of respondents). One of the respondents was interviewed twice, once during each round, to follow up on some reflections made after the first interview. The majority of the interviews were conducted one-on-one, although in some cases, two or three respondents were present together (see Table 2 for details), as multiple individuals were involved in making decisions regarding intangibles in those companies.

The interviews were semistructured or "guided" interviews (see Morse, 2012), based on an interview guide that was refined during the data collection process (see Appendix for the final version). One reason for this refinement was an emerging insight that many respondents referred to how their company was perceived by others when preparing financial reports, which led the researchers to focus on the issue of legitimacy. It became apparent that preparers based their decisions on normative considerations during the preparation process. To analyze the empirical material and understand the characteristics of

Company (group)	Respondent(s)	Size (as defined by market segment)	Sector	Interview duration
Company A	CFO	Small	Health care	56 min
Company B	CFO	Small	Technology	54 min
Company C	CFO	Small	Industrials	61 min
Company D	CFO	Small	Health care	60 min
Company E	CFO	Small	Technology	66 min
Company F	CFO	Medium	Health care	47 min
Company G	Group Controller	Medium	Consumer	80 min
Company H	Group Accounting Manager	Medium	Cyclical	93 min
Company I	CFO	Medium	Technology	51 min
Company J	Group Accounting Manager	Medium	Consumer	77 min
Company K	Group Treasurer	Medium	Health care	69 min
Company L	Group Financial Controller	Medium	Consumer	57 min
Company M	Group Accounting Manager	Medium	Cyclical	92 min
Company N	– Group Financial Reporting Manager – Controller (There were two respondents interviewed together)	Large	Industrials	61 min
Company O	– Senior Advisor Accounting and Special projects	Large	Industrials	59 min
Company P	– Chief Group Reporting – Group Reporting staff – Group Reporting staff (There were three respondents interviewed together)	Large	Industrials	38 min
Company Q	Group Accounting Manager	Large	Industrials	68 min
Company R	Accounting Manager	Large	Industrials	37 min
Company S	– VP, Country Controller – VP, Head of Shared Accounting Services Sweden (There were two respondents interviewed together)	Large	Industrials	33 min
Company T	Financial Manager	Large	Industrials	89 min
Company U	Group Accounting Manager	Large	Consumer	93 min
Company V	Group Accounting Manager	Large	Cyclical	47 min
Company W	CFO	Small	Consumer	59 min
			Defensive	48 min
			Technology	

Table 2.
List of respondents

Source: Created by authors

the legitimization process among the companies, the interview guide was informed by the ideas of norms and legitimacy. The interview questions addressed the underlying reasoning behind the judgments and decisions to understand the rationale behind these norms. The guide was, therefore, consistent with these ideas as well as informed by the empirical

phenomenon of recognition and measurement of intangibles. The participants were free to respond to the questions in an open-ended manner.

Of the 24 interviews conducted, 21 were face-to-face, and the rest were conducted over the phone. The interviews typically lasted between one and one and a half hours. All interviews were recorded with the respondents' permission and subsequently transcribed in full text.

4.3 Data analysis

Accounting decisions about intangibles, including recognition, are important for all companies, regardless of their size, industry or balance sheet structure. However, it is important to be aware of the potential impact of these corporate characteristics on accounting decisions, so we took them into consideration. We did this by using a triangulation approach, proposed by [Denzin \(1970\)](#), which involved cross-validating the annual reports with insights gathered during interviews. While prior research, such as [Lev \(2019\)](#) and [Barker et al. \(2022\)](#), has pointed out notable variations in how companies handle intangibles based on factors like size or industry, our analysis indicated that there were no significant discrepancies in their thought processes and reasoning associated with balance sheet structure, size or industry. We found that companies of different sizes, industries and balance sheet structures have similar reasoning when it comes to legitimacy and decision-making. For instance, both small technology companies and medium-sized consumer cyclical companies discuss how legitimacy affects their decisions. In addition, a respondent from a small health-care company discusses credibility issues similar to a respondent from a large industrial company. Therefore, we instead focused on an in-depth analysis of the interviews. The norms presented below include examples from various industries, as well as companies with different sizes and balance sheet structures. Thus, the empirical material indicates that companies share comparable reasoning and arguments regarding the recognition and measurement of internally generated intangible assets.

The analysis of the interviews in this research project has been an ongoing and inclusive process, involving all authors. As such, there has been a continuous definition and redefinition of relevant themes in the data (cf. [Bazeley, 2013](#)). The categorization of the empirical material emerged through a process of stages based on readings of the material and the initial literature-based understanding.

The analysis consisted of a two-step procedure. In the first step, the abstraction process emphasized descriptions and interpretations from the quotes, where topics and issues (also known as meaning units) were labeled with different codes. The codes were theoretically guided by the research aim and the theoretical perspective but remained open to what was found in the data rather than a deductive application of concepts imported from the literature (cf. [Roulston, 2014](#)). This allowed for a gradual building of understanding based on the interviews while reflecting upon the literature and rearranging codes. The first step generated insights that were used to further abstract the process.

In the second step, a more focused coding was performed, where the first-order coded categories were further developed (cf. [Bazeley, 2013](#)). Two authors conducted this coding, and then the other two authors discussed it further, after which the codes were grouped into three norms of legitimacy based on common rationales. These three norms (consistency, credibility and reasonableness) are presented and discussed in the next section.

5. Findings

Although IAS 38 sets out a framework for recognizing and measuring intangible assets, it also allows for considerable judgment to be exercised. This is particularly true for the

recognition and measurement of internally generated intangible assets, which is a complex task due to the nature of these assets. In accordance with the guidelines set out in IAS 38, those responsible for preparing financial reports must make decisions regarding the appropriate timing of recognizing expenditures on the balance sheet and assess the potential future economic benefits and costs associated with the specific asset, for instance, as the following quotes demonstrate:

IAS 38 is worded in a manner that allows for interpretation. If a financial benefit is expected from an action, it should be reflected on the balance sheet. This can be interpreted in either a lenient or a cautious manner. (Controller, Company N)

It's a matter of judgment, and providing sound reasoning to support one's position is crucial. Accounting decisions are not always clear-cut; they often fall within a spectrum of possibilities with varying degrees of complexity and nuance. (CFO, Company B)

There's scope for making assessments that can vary depending on the situation at hand. One might refer to it as situational assessments. (CFO, Company W)

The flexibility provided by IAS 38 has advantages, as it is a principles-based standard that enables preparers to consider different factors and scenarios when deciding about internally generated intangibles. According to a respondent from Company N, "It [the standard] is quite vague, but that actually provides us with the flexibility to interpret it in different ways. And that's precisely what we have done!" This flexibility is particularly valuable due to the complexity of these assets. IAS 38 distinguishes between the generation of intangible assets during the research phase and the subsequent development phase, and it allows considerable latitude in the treatment of costs incurred during the development phase. Consequently, preparers can make informed decisions regarding ongoing and future projects during both the planning and development stages. As one respondent clarified, this involves comparing and assessing various scenarios before reaching a decision:

When reviewing a budget alongside a business plan, we evaluate which projects to recognize. We may opt for scenario 2 or 3, in which we include various large-scale projects, or scenario 1, in which we focus on development or custom-made projects that may not meet the same recognition criteria. The outcomes will have varying impacts on the income statement, which we carefully assess before making any decisions. This process allows us to gain a clear understanding of how different development projects will affect the bottom line and the balance sheet, and helps us make informed decisions. (CFO, Company B)

However, the flexibility of the standard also has its drawbacks. Respondents in the study emphasize the significance of substantiating decisions related to the recognition and measurement of internally generated intangibles with sound arguments because the standard permits various possibilities based on the interpretations made by the preparers. While the flexibility of the standard provides preparers with different possibilities and judgments within its framework, the respondents also emphasize how its broadness affects the actual outcome of the decisions and the resulting numbers presented in financial reports. As preparers, they acknowledge that the flexibility of the standard leads to subjectivity in the reports:

Honestly speaking, there is subjectivity at play here. (Vice President and CFO, Company F)

The standard is intentionally designed to require interpretation, and it is during the interpretation process that difficulties can arise from time to time. (Group Accounting Manager, Company U)

In theory, it may seem good, but in practice, I do not think it works particularly well due to the high level of subjectivity involved in assigning values. (CFO, Company D)

There is a wide range of discretion involved in these assessments. Personally, I find the IFRS model somewhat problematic. (CFO, Company D)

To make decisions about how much to recognize and when to recognize, preparers rely on an ongoing and iterative process of interpretation and deliberation. As we will elaborate on below, specific norms guide preparers in their judgments and decisions regarding recognizing and measuring of intangible assets. To deal with the flexibility of the standard, preparers rely on norms that shape the outcome of the accounting process. These norms are crucial for recognition, where respondents state that it is easy to recognize projects if they want to but sometimes refrain from doing so because recognition must be justifiable to external parties. On the other hand, respondents state that it would be odd not to recognize expenses when there are no revenues. Therefore, legitimacy-oriented norms guide the judgments and decisions regarding internally generated intangible assets. We find that three underlying norms guide preparers, namely, consistency, credibility and reasonableness. Below, we will elaborate on and substantiate these three underlying norms of legitimacy.

5.1 Consistency

One underlying norm of legitimacy that guides preparers in their reasoning regarding the recognition and measurement of internally generated intangibles is *consistency* (see upper part of Table 3). While IAS 38 emphasizes the importance of consistency in the use of methods for revaluation and amortization, this norm extends beyond accounting methods to how the company is perceived by external stakeholders. Preparers face a multitude of judgments but make thoughtful considerations regarding the recognition and measurement of internally generated intangibles, as it is crucial for the company to appear congruent in the eyes of stakeholders such as analysts, investors and other users of financial reports.

Norms of legitimacy	Main characteristics
Consistency	• Congruence and coherence in accounting practices are important • Maintaining a balance between intangible asset recognition and write-downs requires prudence and consistency in recognizing development expenses • Building and maintaining stakeholder trust and confidence is crucial, which can be achieved through consistent and controlled financial reporting
Credibility	• Transparency is crucial in building trust and maintaining a positive reputation among stakeholders • Proper recognition is essential to meet stakeholder expectations • Maintaining accuracy, especially during difficult times, is vital to maintain the trust of stakeholders
Reasonableness	• Communicating precise and reliable information to stakeholders • The financial statements must reflect the company's operations accurately • Ensuring the overall financial statements are reasonable.

Table 3.
Norms of legitimacy **Source:** Created by authors

Consistency compels preparers to exercise prudence when it comes to recognizing internally generated intangible assets, as a hasty recognition decision can result in impairment losses and, ultimately, disrupt the consistency of financial reports. In fact, some interviewees even described their pursuit of consistency as a virtue. Preparers use past financial reports as a benchmark when making such decisions to maintain consistency over time:

We are actually quite consistent. [...] Our strength lies in the fact that we have been using the same model for many years. (Senior Advisor Accounting, Company O)

We have not changed [our way of measuring] in the ten years I have been here. If the approach is consistent, that's what matters. [...] We avoid any actions that might lead to surprises in the future. (Group Accounting Manager, Company V)

As a publicly listed company, we consider external assessors, analysts, and potential shareholders. Therefore, our accounting practices should be fair. If we expense all costs, the result may appear deceptively low compared to the representative result over time. (CFO, Company I)

The above quotes all emphasize the importance of consistency in accounting practices. They stress the need for using the same model or approach over time, which is similar to the requirement for consistency in accounting policies under IAS 1 (para. 45). The main motivation behind this practice appears to be avoiding unexpected outcomes, although ensuring sound financial reporting is also a significant aspect. For instance, the Group Accounting Manager from Company V emphasizes the importance of consistency in their measuring approach, while the Senior Advisor from Company O believes that using the same model for many years is a strength. The CFO from Company I highlights the significance of fair accounting practices for a publicly listed company and notes that expensing all costs could result in a deceptively low outcome compared to the representative result over time. Overall, these quotes highlight the significance of consistent and fair accounting practices and their role in maintaining the trust of external assessors, analysts, potential shareholders and the public.

It is important to note that consistency is not limited to the measurement of intangibles in terms of the figures presented on the balance sheet but also involves forward thinking to ensure that income statements and results remain consistent and do not fluctuate significantly over time. Respondents are careful to match revenues and expenses in the correct time period to present income statements and results that remain consistent over time. If a company fails to maintain consistency in recognizing internally generated intangibles, this is perceived as a sign of financial distress:

Companies facing profitability issues tend to recognize higher levels [of development expenses], while those performing well have less incentive to do so. [...] However, it is also important to ensure that recognition aligns with the corresponding revenue. For instance, it would be unwise to incur expenses now if the expectation is that revenue will be generated from it only in the following year. (Group Accounting Manager, Company M)

In essence, it's important to exercise caution when it comes to borderline projects. Instead of recognizing them, we tend to expense them. This helps to ensure consistency in our year-on-year results. We strive to strike a balance between recognition and write-downs in our financial reports. We recognize projects only when we're confident that they will yield an actual product. (CFO, Company D)

These statements underscore the significance of exercising prudence in recognizing development expenses, as well as ensuring consistency in financial reporting over time. The

first statement brings attention to the tendency of companies experiencing profitability challenges to over-recognize expenses and the importance of aligning recognition with corresponding revenue. The second statement emphasizes the importance of exercising judgment when dealing with projects that fall into a gray area. A “borderline project” is one that is on the verge of meeting certain criteria or thresholds, such as having an uncertain status or falling into a gray area where it may not clearly qualify for capitalization. This means that it may be treated as an expense instead. The reasoning implies that such projects should only be recognized when there is a high degree of certainty that the actual product will be realized. Both statements emphasize the importance of achieving a balance between expense recognition and write-downs while maintaining consistency in financial reporting.

Interestingly enough, using previous financial reports as a reference point provides preparers with a sense of control. The pursuit of consistency provides reference points that create structure among preparers:

[The quarterly reports] provide a deadline, which is beneficial. One must bear in mind that subsidiaries often strive to present good results, and therefore may be tempted to recognize items retrospectively. However, when you reach Q4, you cannot disregard what was reported in Q3. This is really beneficial as it provides good control for us of the entire process. (Group Financial Controller, Company L)

Making write-downs is a terrible thing; it's really sad. You feel like the business is doing great, and then suddenly you have to deal with this crap. It's the worst thing that can happen, no matter the project. [...] When you have such deviations, it affects everyone's mindset. Management, operations, the board, and the public don't like it. It's sudden, and people start wondering if there are more problems. That's why we're careful about recognition. (CFO, Company E)

This highlights the significance of control and consistency in financial reporting. The Group Financial Controller from Company L stresses the importance of recognizing results retrospectively and having good control over the entire process. On the other hand, the CFO from Company E emphasizes the potential negative consequences of deviations in financial reporting and stresses the importance of exercising caution in development expense recognition to avoid write-downs. The statement from the Company E respondent underscores a legitimacy concern, indicating that write-downs are unpopular not only among internal stakeholders but also with the broader public. This highlights the significance of maintaining a consistent image and reputation in the eyes of all stakeholders, making it a crucial aspect for the company. Overall, it suggests that consistent and controlled financial reporting is crucial for building and maintaining stakeholder trust and confidence.

In summary, the norm of consistency underlying the recognition and measurement of internally generated intangible assets urges preparers to seek congruency and exercise control. This norm is driven by their concern for how the financial accounts will be seen and perceived by important others. By pursuing consistency, preparers can make decisions that ensure their company's financial reports remain coherent over time, portraying a consistent image. Thus, their decisions regarding internally generated intangibles revolve around maintaining legitimacy and control rather than merely complying with IAS 38.

5.2 Credibility

In Table 3, the second part highlights another underlying norm of legitimacy that guides preparers in accounting for their internally generated intangibles: *credibility*. Unlike IAS 38, which focuses on the recognition and measurement of intangible assets, credibility is concerned with how external parties perceive the company. Preparers are careful to make

decisions that are perceived as credible by external stakeholders. They act with prudence, knowing that questionable decisions could impact the company's credibility, particularly among those with accounting knowledge. Two of the respondents indicate that this relates to transparency:

I believe that anyone reading such reports, including analysts and those with a basic understanding of accounting, would find it concerning if there were an excessive number of recognized projects in comparison to projected future earnings. (Group Accounting Manager, Company M)

After all, it's the investors who determine their opinion of the company. [...] When you enter a market with external financing, transparency in reporting is crucial, as it directly affects recognition. (CFO, Company B)

The importance of transparency in financial reporting is emphasized by the respondents, who suggest that recognizing too many projects without corresponding earnings projections may concern stakeholders. They explain how transparent reporting can directly impact investor opinion and recognition. Building trust and maintaining a positive reputation among stakeholders, especially in the context of external financing and investor relations, is crucial, and therefore, there is an emphasis on the need for companies to be transparent in their financial reporting.

For public companies that rely heavily on R&D operations, recognizing intangibles in a manner that appears credible to external parties is critical. Preparers in these companies make decisions guided by external expectations and reason carefully to ensure credibility is maintained. However, it is a delicate balancing act because recognizing too many intangibles could negatively impact credibility. This emphasis on credibility is reflected in the following quotes:

You're judged by investors based on your cash flow, which is the most important thing. However, the amortization period and the level of caution exercised in recognizing assets also play a crucial role. (Group Accounting Manager, Company M)

Recognized development is critical information for external stakeholders. If a company known for its innovation does not recognize any development expenses, it implies that they have no upcoming products to launch. Only products that are being developed can be recognized. Having nothing to recognize means that the company has only existing products, which is not ideal. (CFO, Company A)

You would want to expense as much as possible, but not all of it, because you have invested a significant amount of money into it. You want it to be reflected in the financial statements, as not recognizing it would be misleading. This investment will have significant benefits for many years to come, and hence it should be reflected in the balance sheet. (Group Accounting Manager, Company M)

There is an emphasis on the importance of stakeholder expectations when discussing the significance of the amortization period and the level of caution exercised in asset recognition. The respondents stress the critical nature of recognizing development expenses for external stakeholders, implying that only products that have been recognized should be considered as being developed. They also emphasize the importance of recognizing investments in financial statements, stating that it would be misleading not to do so. All in all, these quotes emphasize the importance of conducting precise and sound financial reporting, as well as appropriately recognizing assets. This would be particularly vital for stakeholders and investors who rely on accurate information to make informed decisions.

Moreover, credibility also means staying committed to the recognition of internally generated intangibles, even during financial stress. A respondent explains how changing the recognition approach during worsening conditions could negatively affect external parties' perception of the company:

On the other hand, you may opt to take a more restrictive approach when faced with a deteriorating economic climate or other challenging circumstances. Overstating revenue during difficult times could lead to disapproval from stakeholders and an inflated balance sheet, which could raise concerns and appear anomalous to stakeholders. (Controller, Company N)

I think it depends on the company's performance. When things go well, it's preferable to expense rather than have a lot of intangible assets on the balance sheet. In our current successful state, we don't want to increase our balance sheet any further. [...] While it's possible to manipulate profits temporarily, eventually, they must be written off. (CFO, Company F)

The norm of credibility underlying the recognition and measurement of internally generated intangible assets is not related to recognition approach. Rather, it involves making decisions that external stakeholders perceive as trustworthy. Preparers consider what would be seen as trustworthy to maintain the company's credibility. This requires making trustworthy decisions and avoiding practices that could raise questions about the company's credibility, such as intentionally recognizing intangibles to achieve higher financial turnover or avoid losses. We observed that the respondents disapprove of such behavior:

It's not uncommon for struggling companies to start recognizing large sums [of development expenses], which is an indication of their lack of profitability. (Group Accounting Manager, Company M)

I have seen examples where companies adjust the amortization of their intangible assets based on their sales revenue. (CFO, Company W)

For companies with negative cash flows, trimming profits may be necessary in the short term, but that is not a concern for us. (Group Accounting Manager, Company H)

To summarize, preparers consider credibility as a guiding norm in accounting for internally generated intangibles. They make decisions that are perceived as trustworthy by external stakeholders, which helps the company appear credible. Accounting for internally generated intangibles is not just about complying with IAS 38 but also about making trustworthy decisions to maintain credibility.

5.3 Reasonableness

If we turn to the final section of [Table 3](#), we observe that a third underlying norm of legitimacy that directs preparers in accounting for internally generated intangibles is *reasonableness*. While there is indeed a link to reasonableness in how IAS 38 guides preparers to make reasonable assumptions when recognizing and measuring internally generated intangibles, the underlying norm of reasonableness is not just about calculating numbers but also about how companies relate to themselves. In other words, reasonableness is about how the company wants to present itself in relation to its actual internal circumstances. This norm guides preparers in their efforts to provide a fair and accurate representation of the business and its operations. For example, two respondents explain:

We acknowledge the significance of developing a model that allows for more recognition. [...] It's not necessarily about achieving better results but rather about conveying accurate signals that align with our operations. (Group Accounting Manager, Company H)

We follow principles rather than strict rules [in IAS 38], which allows for some flexibility. However, our public responsibility and exchange contracts require us to present an accurate and honest representation of our business development, which is just as important as following formal principles. (CFO, Company I)

The signals that a company sends should be consistent with its operations. Reasonableness is not about bending accounting standards to achieve better results or avoid losses. It is about presenting results that accurately reflect the company's true financial condition. While some respondents mention being cautious not to overstate their intangible assets, they are ultimately guided by what they perceive as reasonable from a holistic perspective. In other words, reasonableness is determined by what the preparer considers to be suitable in terms of accurately representing the business:

Well, our goal is to recognize what is reasonable to present an accurate income statement that reflects our business operations. That's what matters. (CFO, Company B)

I believe it is more comfortable [to incur costs] rather than have a lot of them on the balance sheet. However, I also need to consider what is reasonable and strike a balance between the two. (VP, Company S)

As we can see, determining what is reasonable requires a delicate balance for preparers. They must consider the impact on the income statement and balance sheet while also keeping in mind how this will affect the company's overall image. Therefore, reasonableness is about demonstrating financial responsibility based on the company's business operations. Two of the respondents are discussing this balancing act:

Compared to other companies, we recognize a low percentage, particularly in R&D expenses, where we only recognize 25%. [...] We recognize less than many companies, but we would like to recognize more to better reflect our business. [...] It's not like 75% of what we do goes wrong. (Group Accounting Manager, Company H)

The CEO and board want to limit recognition amounts in the budget to avoid a significant negative deficit between depreciations and recognitions. As a successful company, we don't want to appear to recognize just for the sake of recognition. (Group Accounting Manager, Company J)

In addition to ensuring compliance with IAS 38, our respondents, who are CFOs and group accounting managers, act as guardians of financial integrity. They strive to present reasonable financial reports that accurately reflect the overall business. This is essential because groups typically consist of multiple companies, each with its own unique interests. As explained by two of the respondents:

One must bear in mind that subsidiaries often strive to present good results, and therefore may be tempted to recognize items retrospectively. (CFO, Company L)

We aim to achieve the right financial result for our business, but there are always internal discussions about how to do it without incurring excessive costs. [...] As a group accountant and controller, it's our responsibility to ensure that we don't recognize things too soon. We carefully balance this aspect to ensure that our financial statements reflect our business in a reasonable manner. (Group Accounting Manager, Company Q)

It is evident that deciding what is reasonable is a delicate balancing act for preparers. Although the standard grants flexibility, preparers meticulously evaluate what is reasonable from a holistic standpoint when determining how to account for intangibles. As discussed earlier, this entails balancing various internal interests and making decisions based on the nature of the business. However, to appear reasonable, decisions must always be based on the consolidated financial reports' overall picture:

We take a holistic approach when determining how much to write off and what's reasonable, considering the overall impact on the company's financial results. [...] While companies can technically recognize whatever they want, it's crucial that we ensure it is reasonable. (Group Accounting Manager, Company M)

In summary, our research findings suggest that the underlying norm of reasonableness guides preparers to evaluate intangibles based on their understanding of the business and what they consider fair and suitable. The norm of reasonableness means producing financial reports in a way that is consistent with the underlying economic reality of the company's operations, considering the specific circumstances of the industry. We have observed that CFOs and group accounting managers play a crucial role in safeguarding financial integrity, ensuring not only compliance with IAS 38 but also that the consolidated financial statements are reasonable from a holistic perspective.

6. Concluding discussion

The purpose of this study is to identify the norms that underlie and condition the decisions made by preparers of financial reports. In this regard, we have identified normative considerations taken in relation to the standard IAS 38 and the ways in which preparers reason, which reveal the norms that influence their decision-making. Based on our findings, preparers act on the norms of consistency, credibility and reasonableness, which condition their decisions about the financial reports. Our argument is that these underlying normative considerations can be related to legitimacy insofar as they reflect norms of social acceptance (Deegan, 2019). In particular, this pertains to the norms of consistency and credibility, as these are considered in the context of the external interpretations of the company's financial reports. Reasonableness is primarily connected to the internal understanding of what is reasonable given the preparers' knowledge of the company's internal circumstances. This suggests that while legitimacy often involves creating an image or perception of the company's activities as conforming to external social norms, reasonableness, in contrast, is primarily tied to the internal understanding of what is reasonable based on the preparers' knowledge of the company's internal circumstances. This dual perspective highlights the concept of "internal legitimacy," where the focus is on ensuring that financial practices are internally justifiable and sensible within the context of the company's specific situation, in addition to conforming to external norms of social acceptance.

Essentially, these findings suggest a twofold contribution of the article. First, in terms of empirical research, the study has identified specific action-guiding norms that are inherent in the practice of accounting for internally generated intangibles. Second, from a theoretical standpoint, the article highlights the normative basis of the preparers' work as essentially other-directed and nonmoral in nature, which suggests their attempts to attain cognitive legitimacy (Suchman, 1995) to achieve understandability and acceptance by external constituents.

As for the first contribution, our study is, of course, not the first to explore norms and legitimacy in and through financial accounting practices (see, e.g. Aerts, 2005; Aerts and Yan, 2017; Aerts and Zhang, 2014; Cho *et al.*, 2010; Leung *et al.*, 2015; Ogden and Clarke, 2005). As

extant research shows (e.g. [Cho and Patten, 2007](#); [Deegan, 2002](#)), companies have incentives to use communication strategies and financial report disclosures to influence societal perceptions ([Aerts, 2005](#); [Aerts and Yan, 2017](#); [Aerts and Zhang, 2014](#)). However, in this paper, we specify in detail which norms tend to guide action.

We suggest a *reasoning in practice* that cannot be strictly reduced to the application of, for example, the conceptual framework of the IASB (cf. [Georgiou et al., 2021](#); [Nobes and Stadler, 2015](#)). When preparers work with financial reports in practice, it is not simply an “automatic” process of application of existing norms. Rather, it involves interpretations according to what preparers see as relevant. The corollary of this reasoning, however, is hardly in opposition to existing conceptual frameworks but may contain more subjective interpretations of them, for example, the norm of consistency of the IASB. This perspective underscores the tension between the practical application of norms and the theoretical constructs laid out by standard-setting bodies like the IASB. The IASB promotes consistency as a fundamental principle, aiming to enhance the reliability and comparability of financial information across entities and periods. However, the practical application of consistency can be nuanced, as preparers must exercise judgment in determining what is relevant in their specific context. In essence, while the norm of consistency advocated by the IASB remains crucial, its practical implementation may involve varying degrees of subjectivity and interpretation by preparers, which may not necessarily undermine the framework but can result in nuanced outcomes. This highlights the dynamic relationship between theoretical standards and their real-world application, a complexity that deserves attention in the context of financial reporting practices.

Another aspect is that the existence of normative considerations of preparers related to legitimacy does not preclude self-serving considerations among preparers (cf. [Aerts, 2005](#); [Martins et al., 2019](#); and others). This becomes apparent in certain instances within the study, particularly when respondents make reference to the behavior of other companies. One reason for this is that legitimacy is a resource aspired for by companies to gain other resources. However, by identifying the specific norms, we go more deeply into how preparers relate financial accounting practices to normative considerations necessary to obtain legitimacy. We do think that by identifying such a normative base, we can go more deeply into the nature of why financial accounting practices develop the way they do. At least we can show that even though self-interested managerial considerations can be an explanation for accounting decisions (cf. studies such as [Callao and Jarne, 2010](#); [Doukakis, 2014](#); [Ewert and Wagenhofer, 2005](#); [Psaros, 2007](#); [Psaros and Trotman, 2004](#)), they tend to involve other-directed considerations. The preparers of financial reports appear to be guided by concerns about “how others see us” in relation to specific norms.

Prior research has found that earnings management practices may be involved in how companies handle intangibles recognition under IAS 38 (e.g. [Dinh et al., 2016](#); [Mazzi et al., 2022](#)). Our findings support the notion that earnings management does play a significant role in companies’ decisions regarding intangibles recognition, but it is subject to constraints imposed by broader concerns. Specifically, we argue that the principle of *consistency* serves as a substantial constraint on earnings management. This is because *ad hoc* adjustments to financial results in response to short-term earnings developments are inconsistent with the overarching goal of maintaining a consistent and principled approach to intangibles recognition.

In terms of the second (theoretical) contribution, it is clear that the preparation of financial reports (specifically, the recognition and measurement of internally generated intangibles during this process) is guided by a type of reasoning that is connected to how the company is perceived by others, particularly in terms of credibility and consistency. The

nature of the fundamental norms that guide the preparers in this regard is, however, particularly interesting and informative. This study relates to cognitive legitimacy, not moral legitimacy relating to the moral expectations of the external constituents. The context of accounting numbers, thus, is not primarily “moralized” but focuses more on appropriateness and cognitive legitimacy (Aerts and Zhang, 2014; Durocher and Fortin, 2010; Suchman, 1995). For instance, consistency as a norm relates to the logics and understandability of financial statements.

Furthermore, legitimacy is primarily sought through the lens of external audiences, as evidenced by the reasoning of the preparers. Their considerations mainly revolve around how others perceive the company. However, it is important to note that (once again relating the discussion to legitimacy) norms of consistency, credibility and (to some extent) reasonableness relate to the cognitive understanding of the accounting numbers. This highlights the unique character of legitimation through financial accounting, where accounting numbers related to intangibles involve limited moral evaluation but require understandability and meaningfulness. Thus, the nature of the underlying issue or process that is used to achieve legitimacy is crucial in determining the type of legitimacy that can be attained.

It is, reflecting on the study, also worth considering the institutional conditions in Sweden, including norms, values and culture, and whether they contradict the logic behind IFRS and IAS 38. The literature (e.g. Yamani and Almasarwah, 2019; Zeff, 2007) shows that cultures and norms regarding accounting and business tend to vary across countries, which may also result in different interpretations of international principles-based standards. Hence, it remains imperative to acknowledge that within alternative national contexts beyond the scope of this article’s investigation, there may indeed exist additional norms pertaining to legitimation. However, this does not necessarily weaken our study but rather emphasizes the need for further research on the normative basis on which preparers act in relation to legitimacy.

The study has implications for both practice and theory. First, for practice, it is essential for preparers to understand the principles-based standards such as IAS 38 and the discretion allowed in making accounting decisions. Decision-making is a normative exercise that needs to be explained and justified based on the underlying norms. Preparers need to be aware of the norms that guide their accounting decisions and the reasons behind them. Second, from a theoretical perspective, the study sheds light on the cognitive nature of legitimation in financial accounting, as we have identified specific norms that guide preparers (see above). Reasonably, an implication of this for researchers is an insight into how preparers *make sense of various issues in or even forms of accounting* and respond to these in various ways. Different norms may guide preparers in making different accounting decisions, and norms related to cognitive legitimacy (i.e. understandability and meaningfulness) seem to guide preparers in this particular case. Thus, researchers need to be aware of the nature of accounting decisions (e.g. standards) studied as means of legitimation and how certain norms relate to specific accounting decisions. By doing so, a deeper understanding can be gained of why certain decisions are made.

The study is based on insights gathered from CFOs and group accounting managers within organizations, providing a broad understanding of legitimation through financial accounting. However, it should be acknowledged that internal processes within companies may also play a significant role in shaping legitimation. Therefore, future studies could adopt a more contextual approach, exploring not only the normative foundations of legitimation but also the processes and collective aspects within and between organizations.

In addition, other principles-based standards beyond IAS 38 should be examined. To further support or challenge the findings of this study, a wider range of companies could also be included in future research.

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Interview Guide

Introduction/Background

- Discussion around anonymity
- Could you provide some background information about yourself, including your education, years of experience in the company, and expertise?
- In your line of business and industry, what is the role of intangible assets?
 - Are there any specific factors related to your company that should be taken into consideration when discussing intangibles?
 - What are the reasons behind the amount and structure of intangibles in your company?
- What is your company's strategy regarding intangibles? Is there a specific strategy in place?
 - Can you describe your product development process and how it applies to both tangible and intangible assets?
- Is there a policy or manual in place regarding intangible assets, and who is responsible for creating it?
- What is your (company's) perspective on research and development?
 - What is your own role in research and development, and what are you striving for in this area?
- What is your opinion on IAS 38, the standard that regulates research and development?
 - What do you see as the advantages and disadvantages of this standard?

Research phase

- In the opinion of your company, what does the term "research" mean? Can you provide an example?
- How would you (and your company) define "research"?
- To what extent do you document and keep records in connection with research activities? How do you do it? Why is it important to keep records?

Gray area

- The standard recognizes a distinction between the research phase and the development phase. How do you (and your company) perceive this difference?
 - At what point and in what way do you consider the transition from research to development to occur?
- How do you approach the transition from research to development? What are your general thoughts on recognition in this context? Please provide some elaboration on your perspective.
- Where do you make decisions and judgments regarding research and development? What types of decisions and judgments are these? Why are they made?
- What financial considerations are associated with recognition? Is it worth the investment of time and resources?
- In what ways are business outcomes affected by these decisions and judgments?
- To what extent are you proactive about these issues? How much do you anticipate and plan for these decisions?

Development phase

- In the opinion of your company, what does the term "development" mean? Can you provide an example?
- How would you (and your company) define "development"?
- To what extent does your company document and maintain records related to development activities? How and why?
- Looking at para. 57 of IAS 38, how do you perceive and reason about para. 57a? Can you provide an example?
- ...para. 57b? Example?
- ...and so on until para. 57f.

Closure

- What do you think would be important for me to know about these issues?
- To what extent do you discuss these issues among yourselves, and is it a planned discussion? If so, why?
- Is there anything else that you would like to bring up or discuss related to these issues?