



## Rethinking Accounting for Value Creation: Evidence on the Misalignment between Financial Reporting and Economic Reality

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### ABSTRACT

**Purpose:** This study aims to rethink the role of financial accounting in representing economic value by examining the systematic misalignment between financial reporting and the processes through which firms create value. Rather than treating the divergence between accounting numbers and economic reality as a technical or disclosure-related issue, the paper investigates whether this misalignment reflects a deeper structural limitation inherent in the accounting model itself.

**Method / Design / Approach:** The study adopts a conceptual and analytical research design supported by evidence-based illustrations. It integrates insights from accounting theory, capital market behavior, and institutional analysis, complemented by stylized empirical patterns such as persistent market-to-book disparities, investment–performance disconnects, and delayed recognition of value creation and erosion, with particular reference to emerging market contexts.

**Findings:** The analysis demonstrates that financial statements systematically lag economic reality because they are designed to recognize realized outcomes rather than ongoing value creation processes. Core drivers of value—such as organizational capabilities, relational assets, strategic positioning, and institutional embeddedness—are conceptually excluded from financial reporting by design, not by measurement error. This structural misalignment explains persistent valuation gaps, weak contemporaneous links between accounting performance and investment behavior, and delayed signals of economic decline.

**Originality and Value:** The study contributes by reframing the accounting–value gap as a structural misalignment rather than a remediable reporting deficiency. It shifts the debate from improving measurement and disclosure toward reassessing the conceptual boundaries of financial accounting.

**Theoretical, Practical, and Social Implications:** Theoretically, the paper advances a process-based perspective on value creation. Practically, it cautions investors, managers, and policymakers against overreliance on financial statements as comprehensive representations of economic performance. Socially, it

highlights how misinterpreted accounting signals can distort capital allocation and economic policy, particularly in emerging economies.

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## 1. INTRODUCTION

### 1.1 Context and Background

Financial reporting continues to occupy a central position in capital markets, shaping valuation, investment decisions, and economic governance. Accounting standards and conceptual frameworks assume that financial statements provide a faithful and decision-useful representation of firms' economic performance and position. This assumption remains foundational to investor protection, market efficiency, and regulatory oversight. Yet, recent evidence suggests that the informational role of financial statements has become increasingly misaligned with the way value is created in modern firms (Barker & Teixeira, 2018; Dichev et al., 2021).

Contemporary value creation is largely driven by processes rather than transactions. Firms generate economic value through organizational capabilities, strategic coordination, data-driven learning, institutional embeddedness, and long-term investments whose benefits unfold gradually and under substantial uncertainty. These value-generating processes are often collective, relational, and forward-looking, making them difficult to isolate, verify, and attribute to specific reporting periods. Nevertheless, financial reporting remains rooted in a recognition logic that privileges realized outcomes, verifiable transactions, and entity-bound measurements (Bradshaw, Liao, & Ma, 2019; Sunder, 2020).

This growing tension is reflected in several persistent market phenomena. Market valuations increasingly diverge from book values across a wide range of industries, while traditional accounting performance measures show declining contemporaneous associations with investment activity and long-term growth (Ewens, Peters, & Wang, 2020; Lev, Srivastava, & Xu, 2021). Importantly, these patterns are not confined to high-technology firms; they are also evident in regulated industries, infrastructure-intensive sectors, and emerging markets, where value creation is closely tied to institutional arrangements and strategic positioning (Boubaker, Cellier, & Manita, 2022).

In emerging economies such as Egypt, the misalignment between financial reporting and economic reality is particularly salient. Value creation frequently depends on relational contracts, public-private partnerships, regulatory access, and ecosystem participation—elements that remain largely invisible in conventional financial statements. As a result, accounting reports may systematically understate economic strength or fail to signal emerging vulnerabilities, complicating valuation, investment, and policy decisions (Hassan, Elamer, & Fletcher, 2020; Khlif, Ahmed, & Souissi, 2023).

### 1.2 Research Problem Statement

Despite extensive research on value relevance, intangible assets, and disclosure quality, a fundamental problem remains unresolved: financial reporting and economic value creation operate according to different conceptual logics. Prior studies often treat the divergence between accounting numbers and market valuations as a technical issue—attributable to measurement error, conservative recognition rules, or insufficient non-financial disclosure (Barker & Schulte, 2017; Barth, Li, & McClure, 2021). While these explanations are informative, they implicitly assume that the accounting model is capable of capturing economic reality if appropriately refined.

This study argues that such an assumption is increasingly untenable. The core problem is not that financial statements measure value imperfectly, but that they are designed to represent realized outcomes, whereas economic value is created through ongoing processes. Many key drivers of value—organizational learning, strategic optionality, institutional positioning, and relational capital—are conceptually excluded from financial reporting by design rather than by accident (Vardon, Burnett, & Dovers, 2021; Giovannoni, Quarchioni, & Riccaboni, 2022).

Accordingly, the misalignment between financial reporting and economic reality is systematic and structural, not episodic or correctable through incremental reforms. This misalignment raises fundamental questions about what financial accounting can reasonably be expected to represent and how its outputs should be interpreted in modern economies.

### 1.3 Research Objectives and Questions

The primary objective of this study is to rethink the role of financial accounting in representing value creation by examining the structural origins and consequences of the misalignment between financial reporting and economic reality.

Specifically, the study aims to:

1. Explain why the misalignment between accounting information and economic value is structural rather than technical.
2. Identify forms of value creation that are inherently excluded from financial statements by design.
3. Illustrate how this misalignment manifests in observable market and organizational patterns.
4. Examine the economic consequences of this misalignment for investors, managers, and policymakers, particularly in emerging market contexts.

These objectives are addressed through the following research questions:

- Why does financial reporting systematically lag behind economic value creation?
- What dimensions of value creation are conceptually excluded from financial statements?
- How does the misalignment between reporting and economic reality affect valuation, investment behavior, and governance?
- Why are these effects amplified in emerging economies?

### 1.4 Research Significance

This study is theoretically significant because it challenges the dominant framing of the accounting–value gap as a problem of measurement or disclosure. By conceptualizing the gap as a structural misalignment, the study contributes to contemporary debates on the limits of financial accounting and the boundaries of its representational capacity (Deegan, 2021; Mouritsen & Kreiner, 2016).

Practically, the analysis is relevant for investors and managers who rely on accounting numbers to assess performance and allocate capital. Recognizing the structural limits of financial statements can mitigate systematic mispricing, reduce short-termism, and improve strategic decision-making (Bushman, Chen, Engel, & Smith, 2018).

From a policy perspective, the study is especially pertinent for emerging economies, where financial reporting often serves as a primary input into privatization decisions, public-sector performance evaluation, and investment policy. Misinterpreting accounting information in these contexts can have significant economic and social costs (World Bank, 2022).

### 1.5 Research Contributions

This study makes three main contributions. First, it offers a conceptual reframing of the accounting–value relationship by distinguishing clearly between value creation processes and value recognition outcomes. Second, it provides a structural explanation for the persistent misalignment between financial reporting and economic reality, moving beyond technical critiques of accounting measurement. Third, it links this misalignment to concrete economic consequences, thereby connecting accounting design to capital market behavior and policy outcomes.

### 1.6 Research Structure

The remainder of the paper is organized as follows. Chapter 2 examines the concept of value creation and its implications for accounting representation. Chapter 3 analyzes the recognition logic of financial reporting and its structural boundaries. Chapter 4 presents evidence illustrating the misalignment between financial reporting and economic reality. Chapter 5 discusses the economic and market consequences of this misalignment. Chapter 6 outlines implications for accounting thought and practice. Chapter 7 concludes the study and proposes directions for future research.

## 2. ACCOUNTING AND THE CONCEPT OF VALUE CREATION

### 2.1 Introduction: Revisiting the Concept of Value Creation

Value creation has become a central construct in contemporary accounting and financial research, yet its meaning remains deeply contested. Traditional accounting frameworks implicitly equate value creation with realized financial outcomes—revenues earned, costs incurred, and profits reported—thereby assuming that economic value becomes relevant only once it is measurable and verifiable (Barker & Teixeira, 2018; Sunder, 2020). This assumption reflects the historical development of accounting in industrial

economies, where production processes were observable, assets were identifiable, and value realization closely followed value generation.

However, recent research suggests that this outcome-based conception of value creation is increasingly misaligned with modern economic activity (Dichev et al., 2021; Lev, Srivastava, & Xu, 2021). Firms now create value through prolonged processes involving strategic experimentation, organizational learning, institutional positioning, and network participation—activities whose economic significance often precedes their financial realization. As a result, a growing portion of value creation remains unrepresented in financial statements, not because of measurement failure, but because it falls outside the conceptual scope of accounting recognition.

## 2.2 Outcome-Based versus Process-Based Views of Value Creation

The accounting conception of value creation is fundamentally outcome-based. Financial reporting systems are designed to capture the financial consequences of past events, emphasizing reliability, verifiability, and transaction-based evidence (Bradshaw, Liao, & Ma, 2019; Barth, Li, & McClure, 2021). From this perspective, value exists only once uncertainty is resolved and economic benefits are realized through completed exchanges.

In contrast, a growing body of interdisciplinary research conceptualizes value creation as a process-based phenomenon. In this view, value is continuously generated through strategic actions, capability development, and relational investments, even in the absence of immediate financial confirmation (Giovannoni, Quarchioni, & Riccaboni, 2022; Boubaker, Cellier, & Manita, 2022). Value creation is therefore not an event but an evolving trajectory shaped by organizational choices and environmental conditions.

This conceptual divergence lies at the heart of the misalignment between accounting and economic reality. While economic value is formed incrementally through processes, accounting recognizes value discretely through outcomes. The issue is not that accounting overlooks value temporarily, but that it defines value in a fundamentally different way.

## 2.3 The Dynamic Nature of Contemporary Value Creation

Modern value creation is inherently dynamic and uncertain. Firms invest heavily in activities such as data infrastructure, platform development, regulatory engagement, and organizational redesign, whose economic benefits are probabilistic and temporally distant (Ewens, Peters, & Wang, 2020; Callen & Segal, 2020). These investments may weaken short-term accounting performance while strengthening long-term competitive positioning.

Empirical evidence increasingly shows that accounting performance measures are weakly associated with contemporaneous investment behavior and future growth opportunities (Bushman, Chen, Engel, & Smith, 2018; Khlif, Ahmed, & Souissi, 2023). This pattern suggests that financial statements do not merely lag value creation but systematically fail to reflect its ongoing dynamics.

Accounting's emphasis on confirmation over anticipation means that value creation is recognized only after its economic effects become sufficiently certain. By that point, much of the informational value for investors and decision-makers may already be dissipated.

## 2.4 Value Creation as a Relational and Institutional Phenomenon

Another defining feature of contemporary value creation is its relational character. Firms increasingly operate within ecosystems where value is co-created through interactions with suppliers, customers, regulators, and partners. Economic benefits often arise from network position, institutional legitimacy, and access to strategic resources rather than from firm-owned assets alone (Hassan, Elamer, & Fletcher, 2020; Vardon, Burnett, & Dovers, 2021).

Financial accounting, however, remains grounded in an entity-centric logic that requires clear ownership, control, and measurability for recognition. Relational value that is jointly created or institutionally embedded cannot be reliably attributed to a single reporting entity and is therefore excluded from financial statements by design (Barker & Schulte, 2017; Mouritsen & Kreiner, 2016).

This exclusion does not imply that accounting is flawed; rather, it reflects the boundaries imposed by its conceptual foundations. Nevertheless, the growing importance of relational value amplifies the gap between accounting representations and economic substance.

## 2.5 Temporal Asymmetry between Value Creation and Value Recognition

Value creation and value recognition operate on fundamentally different temporal logics. Value creation is forward-looking and path-dependent, shaped by expectations, strategic commitments, and institutional evolution. Financial accounting, by contrast, is retrospective, recording the financial consequences of actions once uncertainty is resolved (Ertimur, Francis, Gonzales, & Schipper, 2020; Barker & Teixeira, 2018).

This temporal asymmetry produces systematic distortions. Firms may appear financially stagnant while accumulating significant economic potential, or financially successful while depleting their strategic foundations. Such patterns are particularly evident in periods of structural change, where accounting numbers adjust slowly to shifts in economic reality (Lev et al., 2021).

## 2.6 Beyond Intangibles: A Conceptual Boundary, Not a Measurement Gap

Much of the literature attributes the accounting–value gap to the rise of intangible assets. While intangibles undoubtedly play a role, reducing the problem to asset recognition risks misunderstanding its nature. Many value creation processes—such as organizational learning, strategic optionality, and institutional trust—do not constitute assets in any meaningful accounting sense (Deegan, 2021; Giovannoni et al., 2022).

The persistence of misalignment therefore reflects a conceptual boundary rather than a remediable measurement gap. Expanding recognition criteria may improve disclosure, but it cannot fully reconcile accounting with the realities of modern value creation.

## 2.7 Implications for the Misalignment Argument

By reconceptualizing value creation as dynamic, relational, and process-based, this chapter establishes the foundation for understanding why financial reporting systematically diverges from economic reality. Accounting is effective in recognizing outcomes, but structurally limited in representing value as it is being formed. This conceptual divide sets the stage for the analysis in subsequent chapters, which examine how this misalignment manifests empirically and why it carries significant economic consequences.

## 2.8 Value Creation versus Value Recognition: A Conceptual Divide

A critical distinction underpinning the misalignment between financial reporting and economic reality lies in the difference between value creation and value recognition. While value creation refers to the gradual accumulation of economic potential through strategic, organizational, and institutional processes, value recognition represents the formal acknowledgment of that potential once it has been realized and verified. Financial accounting is explicitly designed to operate at the recognition stage, not at the creation stage (Barker & Teixeira, 2018; Sunder, 2020).

This distinction is often overlooked in accounting debates, where unrealized value is implicitly treated as value that has simply not yet been measured. However, many value creation processes do not merely precede recognition temporally; they are conceptually incompatible with recognition altogether. Strategic optionality, organizational resilience, and institutional legitimacy, for example, are sources of economic value precisely because they remain flexible, uncertain, and context-dependent. Forcing such phenomena into recognition-based frameworks would undermine their economic meaning (Giovannoni et al., 2022; Mouritsen, 2020).

Accordingly, the misalignment between accounting numbers and economic value should not be interpreted as a delay that accounting will eventually correct. Rather, it reflects a categorical distinction between what accounting is designed to recognize and what modern economies increasingly value.

## 2.9 Why Accounting Privileges Outcomes over Processes

The privileging of outcomes over processes in financial accounting is not accidental; it is a deliberate design choice rooted in concerns about reliability, verifiability, and comparability. Accounting standards prioritize evidence that can be independently verified and consistently applied across firms and periods, even at the cost of representational completeness (Barth et al., 2021; Bradshaw et al., 2019).

This design logic was historically justified in environments where economic activity was dominated by tangible production and transactional exchange. In such contexts, the lag between value creation and value realization was relatively short, and accounting outcomes provided a reasonable proxy for underlying economic performance. However, as economies have shifted toward

knowledge-based, relational, and institutionally embedded forms of value creation, this proxy has weakened (Lev et al., 2021; Ewens et al., 2020).

Attempts to incorporate process-based information into financial reporting often encounter resistance because they challenge the epistemic foundations of accounting. Anticipating value creation requires judgment, narrative interpretation, and contextual understanding—features that sit uneasily with accounting’s commitment to objectivity and auditability. As a result, accounting continues to favor outcomes even when those outcomes provide an increasingly incomplete picture of economic reality (Power, 2020).

### **2.10 The Structural Nature of Misalignment**

Understanding the misalignment between financial reporting and economic reality as structural rather than technical has important implications. A technical problem implies the existence of a solution within the existing framework, such as improved measurement techniques, expanded recognition criteria, or enhanced disclosure requirements. A structural problem, by contrast, arises from the foundational assumptions of the system itself.

Financial accounting is structurally aligned with a world in which value is discrete, entity-specific, and realized through transactions. Modern value creation, however, is often continuous, relational, and distributed across networks. No amount of incremental reform can fully reconcile these fundamentally different logics without transforming the nature of accounting itself (Boubaker et al., 2022; Vardon et al., 2021).

This perspective helps explain why successive waves of accounting reform—ranging from fair value measurement to expanded non-financial disclosure—have not eliminated the gap between financial reporting and market valuation. Such reforms may improve transparency at the margins, but they do not alter the outcome-based orientation of accounting recognition.

### **2.11 Emerging Market Implications: Egypt as a Revealing Context**

The structural misalignment between financial reporting and economic reality is particularly visible in emerging market contexts, where value creation is frequently embedded in institutional arrangements, state–market interactions, and long-term strategic positioning. In countries such as Egypt, firms often derive economic strength from regulatory access, public-sector collaboration, infrastructure integration, and relational contracting—sources of value that are largely invisible in conventional financial statements (Hassan et al., 2020; Khlif et al., 2023).

As a result, accounting reports may systematically understate economic resilience or fail to signal emerging risks in a timely manner. This has implications not only for investors but also for policymakers who rely on financial statements to evaluate privatization outcomes, public enterprise performance, and investment priorities. In such environments, misinterpreting accounting information can lead to persistent mispricing, inefficient capital allocation, and suboptimal economic governance (World Bank, 2022).

Egypt thus serves not as an exceptional case but as a revealing one, illustrating how the limits of financial accounting become more pronounced when value creation is institutionally and relationally grounded.

### **2.12 Chapter Synthesis and Link to the Misalignment Argument**

This chapter has reexamined the concept of value creation through a lens that distinguishes clearly between economic processes and accounting outcomes. By contrasting process-based and outcome-based conceptions of value, it has shown that the misalignment between financial reporting and economic reality is rooted in the design logic of accounting itself.

Financial accounting is effective in recognizing realized outcomes, but structurally constrained in representing value as it is being formed. This constraint does not render accounting obsolete, but it does necessitate a more nuanced interpretation of financial statements and a clearer understanding of their conceptual boundaries.

The insights developed in this chapter provide the conceptual foundation for the subsequent analysis. Chapter 3 examines how the logic of financial reporting institutionalizes these boundaries, while Chapter 4 presents evidence illustrating how the resulting misalignment manifests in observable market and organizational patterns.

### 3. FINANCIAL REPORTING LOGIC AND ITS STRUCTURAL BOUNDARIES

#### 3.1 Introduction: Financial Reporting as a Designed System

Financial reporting is often treated in the literature as a neutral technical apparatus whose outputs reflect underlying economic reality with varying degrees of accuracy. Such a view implicitly assumes that deficiencies in financial statements stem from measurement error, implementation problems, or insufficient disclosure. However, this assumption overlooks a more fundamental issue: financial reporting is not a passive mirror of economic activity but a designed institutional system shaped by specific objectives, constraints, and epistemic commitments (Barker & Schulte, 2017; Power, 2020).

Accounting standards embody a particular logic of representation—one that prioritizes reliability, verifiability, and comparability over completeness or anticipatory relevance. This design logic determines not only how information is measured, but also what kinds of economic phenomena are deemed representable in the first place. As a result, the boundaries of financial reporting are not accidental; they are intrinsic to the system's architecture.

This chapter argues that the misalignment between financial reporting and economic reality originates in this design logic. To understand why financial statements systematically lag value creation, it is necessary to examine the foundational principles that govern accounting recognition and measurement.

#### 3.2 Recognition Logic: Verifiability over Economic Substance

At the core of financial reporting lies the principle of recognition. Accounting standards require that economic phenomena be recognized in financial statements only when they meet specific criteria, including identifiability, control, measurability, and reliable verification. These criteria are intended to protect users from speculative or biased information, thereby enhancing trust in reported numbers (Barth, 2018; Christensen, Hail, & Leuz, 2021).

However, this emphasis on verifiability imposes a significant constraint on representational scope. Many economically meaningful activities—such as capability development, strategic repositioning, and institutional negotiation—do not generate immediately verifiable outcomes. Consequently, they are excluded from recognition even when they materially affect firms' future economic prospects (Barker & Penman, 2020; Dichev, 2023).

This exclusion is not a flaw in implementation but a direct consequence of accounting's epistemic stance. Financial reporting privileges evidence that can be corroborated *ex post*, which inherently biases the system toward outcomes rather than processes. Economic substance is thus filtered through the lens of confirmability, creating a systematic delay between value creation and value recognition.

#### 3.3 Historical Cost and the Anchoring of Accounting Time

The temporal orientation of financial reporting further reinforces its outcome-based logic. Historical cost accounting anchors measurement to past transactions, emphasizing the prices at which assets were acquired rather than their evolving economic significance. Although fair value measurement has expanded in certain domains, historical cost remains the dominant paradigm for large portions of financial statements (Plantin, Sapra, & Shin, 2018; Penman, 2021).

This temporal anchoring reflects a deliberate preference for stability and auditability. By tying measurement to observable past events, accounting reduces estimation uncertainty and enhances comparability across firms and periods. Yet, this same feature limits accounting's ability to capture forward-looking value creation, particularly in environments characterized by rapid change and strategic uncertainty (Kothari, Ramanna, & Skinner, 2019).

As a result, financial statements tend to provide a retrospective snapshot of economic activity, even when the most value-relevant information concerns future trajectories rather than past transactions. This temporal mismatch is a central source of the structural misalignment between reporting and economic reality.

#### 3.4 Entity-Centric Reporting and the Fragmentation of Value

Another foundational element of financial reporting design is its entity-centric orientation. Accounting standards require firms to report on their activities as discrete legal entities, drawing clear boundaries around assets, liabilities, revenues, and expenses. This approach aligns with traditional notions of ownership and accountability but sits uneasily with contemporary forms of value creation that span organizational and institutional boundaries (Moll, Burns, & Major, 2018; Bini & Bellucci, 2020).

In modern economies, value is frequently co-created through alliances, platforms, supply chains, and public-private arrangements. Economic benefits arise not solely from firm-owned resources but from positions within networks and ecosystems. Yet, entity-based reporting fragments these relational dynamics, attributing value only where legal control can be established.

The consequence is a systematic underrepresentation of network-based value creation. Financial statements may accurately report entity-level outcomes while obscuring the relational processes that generate those outcomes. This fragmentation further amplifies the gap between accounting representations and economic substance.

### **3.5 Comparability as a Constraint on Representational Richness**

Comparability is widely regarded as a cornerstone of high-quality financial reporting. Standard setters emphasize uniform measurement rules to facilitate cross-firm and cross-period comparisons. While comparability enhances the usefulness of accounting information for benchmarking and regulatory oversight, it also constrains representational richness (De Franco, Hope, & Jin, 2019; Leuz & Wysocki, 2016).

Value creation processes are inherently heterogeneous, shaped by firm-specific strategies, institutional contexts, and environmental conditions. Forcing such diversity into standardized reporting formats inevitably strips away contextual detail. Financial reporting thus achieves comparability at the expense of sensitivity to the unique pathways through which firms create value.

This trade-off is not merely technical; it reflects a normative choice embedded in accounting design. By prioritizing comparability, financial reporting accepts a degree of abstraction that distances reported numbers from underlying economic processes.

### **3.6 Interim Synthesis: Structural Boundaries of Financial Reporting**

The analysis thus far highlights several structural boundaries inherent in financial reporting design. Recognition criteria privilege verifiable outcomes over evolving processes. Measurement conventions anchor accounting to the past rather than future-oriented value creation. Entity-centric reporting fragments relational value, and comparability requirements suppress contextual richness.

Together, these features constitute a coherent design logic that explains why financial reporting systematically diverges from economic reality. The misalignment observed in capital markets is therefore not a consequence of isolated accounting choices but an emergent property of the financial reporting system as a whole.

This understanding sets the stage for the next part of the chapter, which examines how attempts to reform financial reporting—through fair value, expanded disclosure, and integrated reporting—have struggled to overcome these structural boundaries.

### **3.7 Fair Value Measurement: Expansion without Resolution**

Fair value measurement has frequently been presented as a solution to the growing gap between financial reporting and economic reality. By incorporating current market-based estimates into financial statements, fair value accounting aims to enhance relevance and reduce the temporal lag inherent in historical cost measurement. In principle, this shift should bring accounting numbers closer to firms' underlying economic value (Laux & Leuz, 2009; Magnan, Menini, & Parbonetti, 2015).

However, recent research suggests that fair value measurement has not eliminated the structural misalignment between reporting and value creation. While fair values may update asset prices more frequently, they remain anchored in market transactions and observable inputs rather than in the processes through which value is generated (Danbolt & Rees, 2008; Barker, 2020). As a result, fair value accounting tends to reprice outcomes rather than illuminate value creation dynamics.

Moreover, the expansion of fair value measurement introduces new forms of abstraction and volatility, particularly in environments characterized by illiquid markets and institutional uncertainty. Rather than resolving misalignment, fair value accounting often shifts it from a temporal problem to an epistemic one, raising questions about estimation reliability and interpretability (Song, Thomas, & Yi, 2010; Laux & Leuz, 2010).

### **3.8 Disclosure Expansion and the Limits of Supplementary Information**

Another prominent response to the limitations of financial reporting has been the expansion of disclosure requirements. Narrative reporting, management discussion and analysis, risk disclosures, and forward-looking statements are intended to complement financial statements by providing contextual information about firms' strategies and future prospects (Brown & Tucker, 2011; Beyer, Cohen, Lys, & Walther, 2010).

While enhanced disclosure can improve transparency, it does not alter the underlying recognition logic of financial accounting. Disclosures remain supplementary, non-integrated, and often weakly connected to recognized numbers. Consequently, they do not fundamentally change how value is represented within the core financial statements (Healy & Palepu, 2001; Hope, 2013).

Empirical evidence further indicates that users struggle to incorporate extensive narrative disclosures into valuation and decision-making processes. Information overload, boilerplate language, and limited comparability reduce the effectiveness of disclosure-based reforms in bridging the gap between reporting and economic reality (Lang & Stice-Lawrence, 2015; Leung & Verriest, 2015).

### **3.9 Integrated Reporting and the Promise of Value Creation Narratives**

Integrated reporting represents a more ambitious attempt to align corporate reporting with value creation processes. By emphasizing connectivity between financial and non-financial information, integrated reporting seeks to explain how organizations create value over time through multiple forms of capital (de Villiers, Rinaldi, & Unerman, 2014; Dumay, La Torre, & Farneti, 2019).

Despite its conceptual appeal, integrated reporting faces significant structural constraints. It remains largely voluntary, loosely standardized, and weakly enforced. More importantly, integrated reports coexist alongside traditional financial statements rather than transforming them. As a result, the outcome-based logic of financial accounting remains intact, while process-based narratives are relegated to peripheral reporting channels (Higgins, Stubbs, & Love, 2014; Flower, 2015).

Studies examining the capital market effects of integrated reporting yield mixed results, suggesting that while such reports may enhance corporate legitimacy, they do not fundamentally alter how markets interpret accounting numbers (Bernardi & Stark, 2018; Barth, Cahan, Chen, & Venter, 2017).

### **3.10 Why Reporting Reforms Do Not Eliminate Structural Misalignment**

The limited impact of fair value, disclosure expansion, and integrated reporting reflects a common misconception: that misalignment between financial reporting and economic reality is a technical problem amenable to incremental reform. This chapter argues instead that misalignment is structural, arising from the foundational assumptions of financial accounting.

All major reform efforts operate within the same conceptual boundaries: entity-centric reporting, outcome-based recognition, and an emphasis on verifiability and comparability. As long as these assumptions remain unchanged, reforms can only modify the surface features of financial reporting without addressing its representational limits (Hopwood, 2009; Young, 2014).

This insight helps explain why successive waves of reform have failed to reconcile accounting numbers with market valuation in a lasting way. The persistence of misalignment is not evidence of regulatory failure, but of the enduring relevance of accounting's original design logic in a fundamentally changed economic environment.

### **3.11 Chapter Synthesis and Link to Subsequent Analysis**

This chapter has examined the logic and structural boundaries of financial reporting, demonstrating how recognition criteria, measurement conventions, entity-based reporting, and comparability requirements collectively shape what accounting can represent. It has further shown that prominent reform initiatives—fair value measurement, expanded disclosure, and integrated reporting—have not eliminated the misalignment between financial reporting and economic reality.

The key Implication Is that misalignment should be understood as an Inherent feature of the financial reporting system rather than as a remediable deficiency. Recognizing this feature is essential for interpreting accounting information responsibly and for avoiding misplaced expectations about the capacity of financial statements to capture value creation processes.

The next chapter builds on this foundation by examining evidence of misalignment in practice, illustrating how the structural boundaries identified here manifest in observable market behavior and organizational outcomes.

## **4. EVIDENCE OF MISALIGNMENT BETWEEN FINANCIAL REPORTING AND ECONOMIC REALITY**

### **4.1 Introduction: From Conceptual Limits to Observable Evidence**

The preceding chapters established that the misalignment between financial reporting and economic reality is rooted in the structural design of accounting. This chapter moves from conceptual analysis to evidence, demonstrating that the misalignment is not merely theoretical but observable in capital market behavior and firm-level patterns. Importantly, the evidence presented here

does not seek to estimate causal effects through econometric modeling. Instead, it focuses on persistent empirical regularities that are difficult to reconcile with the assumption that financial statements adequately reflect ongoing value creation.

Recent accounting and finance research increasingly documents patterns indicating that accounting numbers lag, distort, or incompletely represent firms' economic trajectories, even in well-functioning markets (Barth et al., 2021; Dichev, 2023). These patterns are particularly salient in environments characterized by long investment horizons, institutional complexity, and relational value creation.

#### **4.2 Persistent Market-to-Book Disparities as Stylized Evidence**

One of the most visible manifestations of misalignment between financial reporting and economic reality is the persistence of large and systematic gaps between firms' market values and book values. While market-to-book differences have long been acknowledged, recent studies emphasize that these gaps are no longer cyclical or industry-specific anomalies but enduring features across sectors and jurisdictions (Lev, Li, & Sougiannis, 2022; Penman & Zhu, 2023).

Importantly, these disparities persist even after controlling for growth opportunities, risk, and expected profitability, suggesting that they cannot be fully explained by conventional valuation models based on accounting fundamentals. Instead, they indicate that a substantial portion of economic value remains unrecognized in financial statements as it is being created.

Evidence from emerging markets reinforces this interpretation. Firms operating in institutionally complex environments often exhibit low book values despite strong market positioning, access to strategic resources, or embeddedness in public-private networks (Khlif & Samaha, 2021; Boubaker et al., 2022). In such cases, accounting numbers systematically underrepresent economic reality rather than temporarily lagging it.

#### **4.3 Weak Contemporaneous Links between Accounting Performance and Investment Activity**

A second strand of evidence concerns the relationship between accounting performance and firms' investment behavior. If financial statements accurately reflected ongoing value creation, one would expect a strong contemporaneous association between reported performance and strategic investment decisions. However, recent empirical research consistently documents weak or unstable links between accounting earnings and investment intensity (Bushman et al., 2018; Chen, Hope, & Wang, 2020).

Firms frequently engage in large-scale investments—such as capability development, digital transformation, or regulatory positioning—during periods of modest or declining accounting performance. Conversely, firms exhibiting strong short-term earnings may simultaneously underinvest in activities critical for long-term value creation. These patterns suggest that accounting outcomes do not reliably signal the economic significance of investment activity as it unfolds.

Moreover, evidence indicates that capital markets often struggle to interpret such discrepancies, leading to delayed price adjustments and persistent valuation errors (Callen & Segal, 2020; Srivastava, 2019). This further underscores the informational gap created by outcome-based financial reporting.

#### **4.4 Delayed Recognition of Value Erosion and Strategic Decline**

Misalignment between financial reporting and economic reality is not limited to value creation; it also affects the recognition of value erosion. Numerous studies document cases in which firms maintain stable or improving accounting performance while their competitive position, strategic coherence, or institutional legitimacy gradually deteriorates (Biddle, Ma, & Song, 2020; Barker & Imam, 2021).

Accounting systems are particularly slow to reflect the erosion of relational and institutional value because such deterioration does not immediately manifest in identifiable losses or impairments. As a result, financial statements may convey a misleading sense of stability until economic decline becomes abrupt and irreversible. This delayed recognition amplifies the consequences of misalignment by masking emerging risks and constraining timely corrective action.

#### **4.5 Emerging Market Evidence: Institutional and Relational Value**

In emerging markets, the misalignment between financial reporting and economic reality is often magnified by institutional characteristics. Value creation frequently depends on regulatory access, state-linked projects, and long-term relational contracting—factors that are only weakly reflected in conventional accounting numbers (Hassan et al., 2020; Elamer, Ntim, & Abdou, 2020).

Evidence from Middle Eastern and North African markets shows that firms' market valuations respond more strongly to institutional positioning and relational signals than to reported accounting performance, particularly during periods of regulatory change or economic reform (Samaha, Khlif, & Hussainey, 2022; World Bank, 2022). These findings reinforce the argument that financial reporting captures only a subset of economically relevant information in such contexts.

#### **4.6 Interim Synthesis**

The evidence reviewed in this patch highlights several recurring empirical patterns: persistent market-to-book disparities, weak links between accounting performance and investment activity, delayed recognition of value erosion, and heightened misalignment in institutionally complex environments. Taken together, these patterns provide compelling support for the claim that the divergence between financial reporting and economic reality is systematic rather than incidental.

The next patch extends this analysis by examining investor behavior, market reactions, and information processing, further illustrating how misalignment affects capital market outcomes and decision-making.

#### **4.7 Investor Attention and Delayed Market Responses**

A growing body of evidence suggests that investors do not process accounting information mechanically or instantaneously. Instead, market reactions depend heavily on attention, interpretive complexity, and the availability of complementary signals. When financial statements fail to reflect ongoing value creation processes, investors face greater difficulty in assessing firms' economic trajectories, leading to delayed or incomplete price adjustments (Hirshleifer, Lim, & Teoh, 2019; Blankespoor, deHaan, Wertz, & Zhu, 2020).

Recent studies show that market reactions to accounting earnings are weaker when firms' value creation relies heavily on long-term investments, strategic repositioning, or institutional change. In such settings, accounting numbers provide limited guidance, and investors rely more on non-accounting signals, analyst narratives, or macro-level information (Drake, Roulstone, & Thornock, 2017; Barberis, Shleifer, & Vishny, 2018). This behavioral dimension reinforces the practical consequences of misalignment by amplifying information processing frictions.

#### **4.8 Information Noise and the Dilution of Accounting Signals**

Misalignment between financial reporting and economic reality also contributes to information noise in capital markets. When accounting numbers do not map clearly onto firms' value creation processes, they become harder to interpret, reducing their informational content. Empirical evidence indicates that such ambiguity increases return volatility, lowers earnings response coefficients, and weakens price informativeness (Kelly & Ljungqvist, 2012; Akbas, Armstrong, Sorescu, & Subrahmanyam, 2017).

Moreover, the proliferation of supplementary disclosures does not necessarily resolve this problem. Instead, excessive or poorly integrated information may overwhelm users, leading to selective attention and heuristic-based decision-making (Bloomfield, 2019; DeHaan, Shevlin, & Thornock, 2015). In this environment, accounting numbers risk losing their central role as focal points for valuation.

#### **4.9 Cross-Sectional Evidence: When Misalignment Is Most Pronounced**

Empirical studies increasingly document that the severity of misalignment varies systematically across firms and contexts. Firms characterized by high strategic uncertainty, intensive capability investment, or strong institutional dependence exhibit weaker associations between accounting performance and market valuation (McNichols & Stubben, 2018; Kothari, Li, & Short, 2009).

Emerging markets further amplify these effects. In such contexts, institutional signals, regulatory expectations, and political connections often play a larger role in shaping economic outcomes than short-term financial performance. As a result, accounting information becomes a less reliable proxy for economic reality, particularly during periods of reform or structural transformation (Boubaker, Nguyen, & Paltalidis, 2020; Alshwer, Sibilkov, & Zaiats, 2021).

#### **4.10 Market Efficiency and Capital Allocation Implications**

The misalignment between financial reporting and economic reality has direct implications for market efficiency. When accounting information fails to convey economically relevant signals in a timely manner, capital allocation decisions may be distorted. Empirical evidence links weak accounting informativeness to mispricing, delayed correction of valuation errors, and inefficient investment flows (Bond, Edmans, & Goldstein, 2012; Edmans, Goldstein, & Jiang, 2016).

Importantly, these inefficiencies are not merely short-lived anomalies. Persistent misalignment can entrench systematic biases in capital markets, favoring firms that optimize accounting outcomes over those that invest in long-term value creation. This dynamic undermines the allocative role of financial reporting and raises concerns about its effectiveness as a governance mechanism.

#### **4.11 Evidence Synthesis: Misalignment as an Enduring Market Feature**

Taken together, the evidence reviewed in this chapter suggests that misalignment between financial reporting and economic reality is neither episodic nor market-specific. Instead, it manifests consistently across different empirical domains: valuation gaps, weak earnings responses, investor attention constraints, information noise, and inefficient capital allocation.

These patterns are difficult to reconcile with the view that financial reporting deficiencies can be resolved through incremental improvements in measurement or disclosure. Rather, they support the argument that misalignment is an enduring feature of an accounting system designed to recognize outcomes rather than represent value creation processes as they unfold.

#### **4.12 Chapter Conclusion and Link to Economic Consequences**

This chapter has demonstrated that the misalignment between financial reporting and economic reality is observable in a wide range of empirical phenomena affecting firms, investors, and markets. By documenting how accounting numbers lag value creation, dilute information signals, and complicate investor interpretation, the chapter provides strong empirical support for the study's central thesis.

The next chapter builds on this evidence by examining the economic and market consequences of misalignment, focusing on how distorted accounting signals influence managerial incentives, capital allocation, and policy decisions, particularly in emerging economies.

### **5. ECONOMIC AND MARKET CONSEQUENCES OF ACCOUNTING MISALIGNMENT**

#### **5.1 Introduction: Why Misalignment Has Real Economic Costs**

The misalignment between financial reporting and economic reality is not merely an informational concern; it has tangible economic consequences that affect how capital is allocated, how managers behave, and how markets function. When accounting numbers fail to reflect ongoing value creation processes, they shape decisions based on incomplete or distorted signals. This chapter examines how such misalignment influences economic outcomes, moving beyond valuation anomalies to analyze its real effects on firms and markets.

Recent research increasingly emphasizes that accounting information plays an active role in shaping economic behavior rather than passively reflecting it. Financial statements influence investment flows, managerial incentives, and regulatory judgments. Consequently, persistent misalignment between reporting and economic reality can propagate inefficiencies throughout the economic system (Leuz & Wysocki, 2016; Christensen, Nikolaev, & Wittenberg-Moerman, 2022).

#### **5.2 Capital Allocation Distortions and Investment Inefficiency**

One of the most significant economic consequences of accounting misalignment is the distortion of capital allocation. Accounting numbers serve as primary inputs for investors, creditors, and analysts when assessing firm performance and allocating resources. When these numbers systematically underrepresent long-term value creation, capital may be diverted away from firms engaging in economically productive but accounting-invisible activities (Bushman & Smith, 2001; Biddle, Hilary, & Verdi, 2009).

Recent evidence suggests that firms whose value creation relies heavily on long-horizon investments—such as capability development, innovation infrastructure, or institutional positioning—often face higher financing constraints and lower market responsiveness compared to firms that generate short-term accounting returns (García-Lara, García-Osma, & Penalva, 2016; Chen, Hope, & Wang, 2020). This bias contributes to underinvestment in projects with substantial long-term economic benefits but weak immediate accounting visibility.

Moreover, misalignment can lead to overinvestment in activities that enhance reported performance without strengthening economic fundamentals. Firms may prioritize projects that improve short-term earnings or balance-sheet metrics at the expense of strategic resilience and adaptability, thereby reinforcing allocative inefficiency at the market level (Edmans, Fang, & Zur, 2013; Biddle, Ma, & Song, 2020).

### 5.3 Managerial Incentives and Short-Termism

Accounting misalignment also reshapes managerial behavior through incentive mechanisms tied to reported financial performance. Compensation contracts, performance evaluations, and debt covenants frequently rely on accounting-based metrics. When these metrics fail to capture value creation processes, managers face incentives to favor actions that improve recognized outcomes rather than those that enhance long-term economic value (Graham, Harvey, & Rajgopal, 2005; Dichev, Graham, Harvey, & Rajgopal, 2016).

Empirical research documents that managers often reduce long-term investments, such as research and development or organizational restructuring, to meet short-term accounting targets. This behavior is particularly pronounced when external monitoring relies heavily on financial statements and when alternative sources of information about value creation are limited (Roychowdhury, 2006; Kothari, Mizik, & Roychowdhury, 2012).

Such short-termism does not arise because managers misunderstand value creation, but because accounting-based evaluation systems reward outcomes rather than processes. Misalignment therefore operates as a governance mechanism that systematically biases managerial decision-making toward actions that are accounting-visible rather than economically optimal.

### 5.4 Market Efficiency and Price Informativeness

At the market level, accounting misalignment undermines price informativeness and weakens market efficiency. Financial statements are intended to aggregate firm-specific information and facilitate accurate price discovery. However, when accounting numbers do not convey timely signals about value creation or erosion, prices adjust slowly and imperfectly to underlying economic changes (Bond, Edmans, & Goldstein, 2012; Kelly & Ljungqvist, 2012).

Recent studies show that stock prices incorporate information about long-term investments and strategic shifts with substantial delay, particularly when such information is not reflected in accounting outcomes (Edmans, Goldstein, & Jiang, 2016; Blankespoor, Miller, & White, 2014). This delayed adjustment increases return volatility, exacerbates mispricing, and weakens the disciplinary role of capital markets.

Accounting misalignment thus contributes to a feedback loop in which distorted prices reinforce inefficient investment decisions, further amplifying economic inefficiencies.

### 5.5 Interim Synthesis

The evidence reviewed in this patch highlights how accounting misalignment generates real economic consequences through distorted capital allocation, managerial short-termism, and reduced market efficiency. These effects underscore that misalignment is not a neutral or benign feature of financial reporting, but a structural condition with significant implications for economic performance and governance.

The next patch extends this analysis by examining broader systemic consequences, including financial stability, policy decision-making, and the amplification of misalignment in emerging market contexts.

### 5.6 Financial Stability and Systemic Risk

Beyond firm-level investment inefficiency and market mispricing, accounting misalignment has broader implications for financial stability. When financial reporting emphasizes short-term outcomes while obscuring gradual value erosion or buildup, risk can accumulate unnoticed within firms and across sectors. Empirical research shows that accounting numbers often fail to signal rising leverage, declining resilience, or strategic fragility until stress materializes abruptly (Acharya, Engle, & Pierret, 2014; Lins, Servaes, & Tamayo, 2017).

This delayed recognition contributes to procyclicality. During expansionary periods, firms with strong reported performance attract capital even if their economic fundamentals are weakening, while firms investing in long-term capabilities may appear unattractive despite strengthening resilience. When conditions reverse, accounting signals adjust sharply, amplifying market volatility and systemic stress (Plantin, Sapra, & Shin, 2018; Danielsson, Valenzuela, & Zer, 2018).

### 5.7 Policy and Regulatory Decision Distortions

Accounting misalignment also affects public policy and regulatory decision-making. Financial statements are widely used to evaluate corporate performance, determine tax bases, assess privatization outcomes, and allocate public resources. When accounting

information fails to reflect economic reality, policy decisions may be based on incomplete or misleading signals (Bushman, Piotroski, & Smith, 2011; Ball, 2016).

Recent studies document that regulators and policymakers often rely on accounting metrics to assess firm viability and sectoral performance, particularly in infrastructure-intensive and state-linked industries. Misalignment can therefore lead to suboptimal regulatory interventions, delayed restructuring, or premature divestment of economically valuable assets (Ramanna, 2015; Kothari, 2020).

### **5.8 Public-Sector and State-Linked Enterprises**

The consequences of accounting misalignment are especially pronounced in public-sector and state-linked enterprises. These organizations frequently create value through long-term service provision, institutional stability, and strategic coordination rather than through short-term profitability. Conventional financial reporting, however, evaluates them primarily through accounting surpluses or deficits, often failing to capture their broader economic contributions (Grossi, Steccolini, & Reichard, 2020; Bracci, Humphrey, Moll, & Steccolini, 2019).

As a result, public-sector entities may appear inefficient or financially weak despite delivering substantial economic and social value. This misrepresentation can distort reform agendas, fuel unwarranted austerity measures, and undermine public trust in state institutions (Lapsley, 2019; Adam, Mussari, & Grossi, 2021).

### **5.9 Amplification in Emerging Market Contexts**

In emerging markets, accounting misalignment is often amplified by institutional complexity, regulatory uncertainty, and state–market interdependence. Firms may derive significant economic value from regulatory access, public–private partnerships, or political legitimacy—sources of value that are systematically excluded from financial statements (Al-Hadi, Taylor, & Al-Yahyaee, 2016; Ben-Nasr, Boubakri, & Cosset, 2015).

Empirical evidence suggests that in such contexts, accounting information plays a weaker role in guiding investment decisions, while non-accounting signals—such as institutional affiliations or policy alignment—carry greater weight. This divergence increases information asymmetry, reinforces insider advantages, and weakens the allocative efficiency of capital markets (Klapper & Love, 2004; Samaha, Khelif, & Hussainey, 2022).

### **5.10 Distributional and Social Consequences**

Accounting misalignment also has distributional and social consequences that extend beyond markets and firms. When accounting systems privilege outcomes that are easily measurable, they may systematically undervalue long-term investments in human capital, environmental sustainability, and social infrastructure. This bias can skew corporate behavior toward activities that generate short-term financial returns while neglecting broader societal value creation (Mazzucato, 2018; Bebbington, Larrinaga, & O'Dwyer, 2020).

Over time, such distortions can contribute to widening inequality, underinvestment in public goods, and erosion of trust in corporate reporting. Recognizing these social consequences is essential for understanding why accounting misalignment is not merely a technical issue but a matter of economic governance.

### **5.11 Chapter Synthesis and Implications for the Study**

This chapter has demonstrated that accounting misalignment has far-reaching economic consequences that extend from firm-level investment decisions to systemic risk, policy distortions, and social outcomes. By shaping how capital is allocated, how risks are perceived, and how performance is evaluated, financial reporting exerts a powerful influence on economic behavior.

The persistence of these consequences reinforces the study's central argument: misalignment between financial reporting and economic reality is a structural feature of the accounting system. Addressing its effects requires not incremental technical fixes, but a more nuanced understanding of what financial accounting can—and cannot—represent.

The final chapter builds on this analysis by summarizing the study's contributions and outlining future research directions that can advance accounting thought beyond outcome-based representation.

## **6. IMPLICATIONS FOR ACCOUNTING THOUGHT AND PRACTICE**

### **6.1 Introduction: From Evidence to Implications**

The preceding chapters have demonstrated that the misalignment between financial reporting and economic reality is structural, persistent, and economically consequential. This chapter moves beyond diagnosis to consider the implications of this misalignment for accounting thought and practice. Importantly, the objective is not to propose technical fixes or new reporting standards, but to reassess how financial accounting is conceptualized, interpreted, and used in decision-making.

Rather than asking how accounting can be modified to fully capture value creation, this chapter asks a more fundamental question: what should financial accounting reasonably be expected to represent? Addressing this question is essential for avoiding misplaced expectations, regulatory overreach, and interpretive errors in both markets and policy arenas (Hopwood, 2009; Power, 2020).

### **6.2 Repositioning Financial Accounting within the Information Ecosystem**

One key implication of the misalignment argument is the need to reposition financial accounting within a broader information ecosystem. Financial statements should not be treated as comprehensive representations of economic value, but as partial, outcome-oriented signals that coexist with other sources of information about firms' strategic and economic trajectories (Beyer et al., 2010; Leuz & Wysocki, 2016).

Recent research emphasizes that users increasingly rely on multiple information channels—including analyst reports, narrative disclosures, industry data, and macroeconomic indicators—to interpret firms' performance. In this context, the value of financial accounting lies not in its completeness, but in its discipline, comparability, and confirmatory role (Christensen, Nikolaev, & Wittenberg-Moerman, 2022; Bloomfield, 2019).

Recognizing accounting as one component of a pluralistic reporting environment helps reconcile its enduring relevance with its representational limits.

### **6.3 Implications for Accounting Theory: Accepting Conceptual Boundaries**

At the theoretical level, the findings of this study challenge the implicit assumption that accounting should evolve toward ever-greater representational completeness. Instead, they suggest that conceptual boundaries are an inherent and necessary feature of financial accounting (Barker & Penman, 2020; Sunder, 2020).

Accounting theory has long grappled with trade-offs between relevance and reliability, but the misalignment perspective re-frames this debate. The issue is not how to optimize this trade-off, but how to acknowledge that certain forms of value creation—particularly those that are process-based, relational, or institutionally embedded—fall outside the representational mandate of financial reporting altogether (Mouritsen, 2020; Giovannoni, Quarchioni, & Riccaboni, 2022).

Accepting these boundaries does not weaken accounting theory; rather, it clarifies its domain and strengthens its internal coherence.

### **6.4 Implications for Standard Setting and Regulation**

For standard setters and regulators, the misalignment argument carries important implications. Efforts to expand recognition criteria or mandate additional disclosures often rest on the belief that financial reporting can be incrementally adjusted to better reflect economic reality. While such reforms may enhance transparency, they risk overburdening financial statements with expectations they cannot fulfill (Young, 2014; Kothari, 2020).

Recent regulatory debates illustrate this tension. Initiatives aimed at integrating forward-looking or non-financial information into core financial reports frequently encounter resistance due to concerns about subjectivity, auditability, and enforcement. The persistence of these concerns underscores the structural constraints identified in this study (Ramanna, 2015; Barth, 2018).

A more realistic regulatory approach would emphasize interpretive guidance and user education rather than continual expansion of accounting scope.

### **6.5 Implications for Auditing and Assurance**

Accounting misalignment also has implications for auditing and assurance. Auditors are tasked with providing assurance on financial statements that are increasingly expected to inform judgments about value creation and risk. When financial statements

systematically exclude key dimensions of economic reality, auditors face heightened expectation gaps (Knechel, Vanstraelen, & Zerni, 2015; Power, 2021).

Recognizing the outcome-based nature of financial reporting can help recalibrate assurance expectations. Auditing should focus on verifying the integrity of recognized outcomes rather than implicitly certifying the completeness of value representation. This clarification is particularly important as assurance services expand into areas such as sustainability and integrated reporting (De Villiers, Rinaldi, & Unerman, 2014).

### **6.6 Interim Synthesis**

This patch has outlined several implications of accounting misalignment for theory, regulation, and assurance. Together, these implications suggest a shift away from viewing financial accounting as a comprehensive representation of economic reality toward understanding it as a disciplined, outcome-oriented information system with clearly defined boundaries.

The next patch extends this discussion by examining implications for managerial decision-making, investor interpretation, professional education, and future research agendas, completing the chapter's contribution.

### **6.7 Implications for Managerial Decision-Making**

Accounting misalignment has direct implications for how managers interpret performance signals and make strategic decisions. When financial statements privilege realized outcomes over ongoing value creation processes, managers may face distorted feedback about the economic consequences of their actions. Empirical research shows that managerial reliance on accounting-based performance measures can discourage investments in innovation, capability development, and organizational transformation when such activities depress short-term reported results (Merchant & Van der Stede, 2017; Abernethy, Bouwens, & van Lent, 2013).

Recognizing the structural limits of accounting information can help managers recalibrate internal decision systems. Rather than treating financial results as comprehensive indicators of value creation, managers should interpret them as lagging confirmations of past actions. This perspective encourages the complementary use of strategic, operational, and forward-looking indicators that capture value creation processes more directly (Hall, 2010; Henri & Wouters, 2020).

### **6.8 Implications for Investor Interpretation and Financial Analysis**

For investors and analysts, accounting misalignment underscores the importance of interpretive judgment. Financial statements provide disciplined and comparable information, but they do not fully reveal firms' economic trajectories. Recent research indicates that sophisticated investors increasingly supplement accounting data with qualitative assessments of strategy, governance, and institutional positioning when evaluating long-term value (Brown, Crowley, & Elliott, 2020; Gietzmann & Pettinicchio, 2014).

Failure to recognize the outcome-based nature of accounting can lead investors to misinterpret weak reported performance as economic underperformance or to overestimate firms that optimize accounting metrics at the expense of long-term resilience. Understanding accounting misalignment therefore enhances investors' ability to distinguish between short-term accounting noise and substantive economic signals.

### **6.9 Professional Education and the Formation of Accounting Judgment**

Accounting education plays a critical role in shaping how future professionals understand and use financial information. Traditional curricula often emphasize technical compliance, measurement rules, and standard application, implicitly reinforcing the view that financial statements are comprehensive representations of economic reality. The misalignment perspective calls for a recalibration of accounting education toward critical interpretation and contextual judgment (Boyce, Greer, Blair, & Davids, 2012; Jackling & De Lange, 2009).

Incorporating discussions of accounting's conceptual boundaries, representational limits, and economic consequences can better prepare accountants, auditors, and analysts to engage with complex reporting environments. Such an approach strengthens professional judgment rather than undermining confidence in accounting practice.

### **6.10 Implications for Emerging and Institutionally Complex Economies**

The implications of accounting misalignment are particularly acute in emerging and institutionally complex economies. In such contexts, value creation is often intertwined with regulatory relationships, state involvement, and long-term developmental objectives. Financial reporting systems imported from developed markets may therefore exhibit heightened misalignment when applied without adaptation (Albu, Albu, & Alexander, 2014; Mir & Rahaman, 2005).

Recognizing these contextual differences is essential for policymakers and practitioners in emerging economies. Rather than viewing accounting misalignment as a failure of implementation, it should be understood as a structural feature of globally standardized reporting models operating in diverse institutional settings. This perspective supports more nuanced use of accounting information in economic planning, privatization, and regulatory oversight.

### **6.11 Directions for Future Research**

The findings of this study open several avenues for future research. First, scholars can further investigate how users interpret accounting information in environments characterized by high misalignment, focusing on judgment, heuristics, and information integration. Second, research can explore complementary reporting mechanisms that coexist with financial accounting without attempting to replace it.

Third, comparative studies across institutional contexts can deepen understanding of how accounting misalignment varies across economies and governance systems. Finally, interdisciplinary research integrating accounting with strategy, institutional economics, and behavioral finance can advance a more holistic understanding of value representation in modern economies (Busco, Giovannoni, & Riccaboni, 2018; Englund & Gerdin, 2019).

### **6.12 Chapter Synthesis**

This chapter has examined the implications of accounting misalignment for theory, practice, interpretation, and education. By emphasizing the structural boundaries of financial accounting, it calls for a shift away from unrealistic expectations of representational completeness toward a more informed and critical use of accounting information.

Together with the preceding chapters, this analysis reinforces the study's central contribution: financial accounting remains a vital institution in modern economies, but its role is inherently bounded. Recognizing and respecting these boundaries is essential for improving economic decision-making, governance, and research.

## **7. CONCLUSION AND FUTURE RESEARCH DIRECTIONS**

### **7.1 Purpose and Scope of the Chapter**

This concluding chapter synthesizes the study's arguments, evidence, and implications regarding the misalignment between financial reporting and economic reality. Rather than reiterating detailed analyses from earlier chapters, it consolidates the study's core insights, clarifies what the research does and does not claim, and outlines directions for future research. The objective is to position the study's contribution within contemporary accounting debates and to identify pathways for advancing research beyond outcome-based representations of value.

### **7.2 Summary of Key Arguments and Findings**

The central argument of this study is that the divergence between financial reporting and economic reality reflects a structural misalignment rather than a remediable technical deficiency. Financial accounting is designed to recognize realized outcomes that satisfy criteria of verifiability, reliability, and comparability. Economic value creation, by contrast, increasingly occurs through dynamic, relational, and institutionally embedded processes that unfold over time and often precede observable financial results.

The study has shown that this misalignment manifests empirically through persistent market-to-book disparities, weak contemporaneous links between accounting performance and investment behavior, delayed recognition of value erosion, and heightened mispricing in institutionally complex and emerging market contexts (Barth et al., 2021; Lev et al., 2022). These patterns are not anomalies but enduring features of modern capital markets.

Importantly, the analysis demonstrates that prominent reporting reforms—such as fair value measurement, expanded disclosure, and integrated reporting—have not eliminated this divergence. While such reforms may enhance transparency, they do not alter the outcome-based logic at the core of financial reporting (Barker, 2020; Power, 2020).

### 7.3 Theoretical Contributions

The study contributes to accounting theory in three main ways. First, it reframes the accounting–value gap by distinguishing clearly between value creation and value recognition, emphasizing that these concepts operate on fundamentally different logics. Second, it advances a structural explanation for accounting misalignment, shifting the debate away from measurement optimization toward conceptual boundaries. Third, it integrates insights from accounting, finance, and institutional theory to explain why misalignment persists despite ongoing regulatory reform (Sunder, 2020; Giovannoni et al., 2022).

By clarifying what financial accounting is designed to represent—and what lies beyond its representational mandate—the study strengthens the internal coherence of accounting theory rather than challenging its legitimacy.

### 7.4 Practical and Policy Implications

From a practical perspective, the findings caution investors, managers, auditors, and policymakers against overreliance on financial statements as comprehensive representations of economic performance. Financial reports should be interpreted as disciplined confirmations of past outcomes rather than as real-time indicators of value creation. Misinterpreting accounting signals can lead to short-termism, inefficient capital allocation, and delayed responses to emerging risks (Edmans et al., 2016; Christensen et al., 2022).

At the policy level, particularly in emerging economies, the study highlights the risks of using accounting metrics as sole benchmarks for privatization decisions, regulatory intervention, or public-sector performance evaluation. Recognizing accounting’s structural limits can support more nuanced economic governance and more informed policy judgments (Grossi et al., 2020).

### 7.5 What This Study Does Not Claim

It is important to clarify that this study does not argue that financial accounting is obsolete, nor does it propose replacing financial statements with alternative reporting systems. Instead, it emphasizes that accounting’s enduring relevance depends on a realistic understanding of its boundaries. The study also does not advocate the capitalization of all value-creating activities or the abandonment of verifiability and comparability as guiding principles.

### 7.6 Directions for Future Research

The findings open several avenues for future research. First, behavioral studies can examine how different users interpret accounting information under conditions of high misalignment. Second, research can explore how complementary information sources interact with financial statements in valuation and decision-making. Third, comparative institutional studies can investigate how accounting misalignment varies across regulatory and economic environments. Finally, interdisciplinary research integrating accounting with strategy and institutional economics can further advance process-based understandings of value creation (Busco et al., 2018; Englund & Gerdin, 2019).

### 7.7 Concluding Remarks

This study concludes that the misalignment between financial reporting and economic reality is not a failure of accounting but a reflection of its design. Financial accounting remains a vital institution in modern economies, yet its role is inherently bounded. Recognizing and respecting these boundaries is essential for improving interpretation, governance, and future research in accounting.

## CONFLICT OF INTEREST STATEMENT

The author declares that there is no conflict of interest regarding the publication of this paper. The author has no financial, personal, or professional relationships that could have appeared to influence the work reported in this study.

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