

WHY AND HOW CAN MANAGERIAL ACCOUNTING BE RELEVANT IN THE PUBLIC SECTOR?*

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Public sector services are a significant part of a nation's economy. The public sector, as one of the main performers of an economy, uses resources provided by the taxpayers. Therefore, the efficiency of its operation has high importance. This guides the attention to the role of a proper accounting system in the public sector. However, the role and the main characteristics of public sector accounting systems are disputed. Trends like New Public Management, Good Governance, and Good Government promoted the adoption of accrual accounting in the public sector.

Accrual accounting can provide a more punctual and reliable picture of an organization and can support the usage of managerial accounting tools, in contrast with cash-based accounting. Moreover, accrual accounting can support the creation of better performance measurement systems. The relevance of managerial accounting in the private sector is indisputable; however, this cannot be said in the case of the public sector. The aim of the study is to explain how the goals of public sector organizing trends affect the accounting system, and how managerial accounting can be relevant in the sector.

Introduction

In the last third of the 20th century, public sector organisations were perceived as slow, lacking in responsiveness and overly bureaucratic compared to the private sector, leading to the perception that the public sector was less efficient than the private sector (Peters & Pierre 1998). In addition, governance as a collective decision-making process has also been affected by democratisation and globalisation towards a loosening of state-centred decision-making (Hosszú 2018).

Until the 1980s, the Weberian bureaucratic model was the basis of democratic state organisation, but the management approach became increasingly important. Public sectors were also becoming increasingly large but inefficient and were less and less in line with societal expectations (Pongrácz 2016). The growth of public spending could not be prevented (Kovács 2014).

The aim of the study is to explain how the goals of public sector organizing trends affect the accounting system, and how managerial accounting can be relevant in the sector. The remainder of paper is organised as follows: the next section introduces the factors which called for the development of new state models, and presents the New Public Management, the Good Governance and Good Government trends. This section also points out the differences and similarities of these trends. Section 2 highlights the main advantages of accrual accounting and links these benefits with the objectives

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which are expected to be met by the accounting system. Furthermore, this section introduces the relevance of managerial accounting in the public sector and the possible reasons behind its marginal role.

1. Post-Weberian state models

By the 1970s, state institutions had become over-expansive, placing a heavy burden on citizens. The large welfare states were unable to meet the growing demands on public services, and the idea of a 'cheaper and efficient state' took centre stage (Hosszú 2018). This has led to an increase in calls for public sector reforms (Christensen et al. 2018), and a growing body of opinion calling for the transfer of business and market principles and management techniques to the public sector. These typically aim to increase the operational efficiency and effectiveness of the state while ensuring transparency. The relationship between the public and private sectors has changed, and the role of the state as a strong controller and regulator has become outdated (Peters & Pierre 1998). The argument in favour of reducing the role of the state was that while bureaucrats worked for the government, market actors sought their own welfare (Tullock 1965). For this reason, these actors are more interested in performing their tasks more efficiently and with higher quality.

Increasing pressure on the public administration ultimately led to a reform of the organization of the state. The three strands of these reforms are the technical approach, the value- and participation-based approach and the regulatory approach (Torma 2010). Their main features are summarised in Figure 1.

Figure 1

Theoretical models of management reform

Approach	Technical	Value- and participation-based	Regulatory
Related model	New Public Management – NPM	Good Governance	Neo-Weberian approach / Good Government
State	weak state	weak state	strong state
Ideology	priority of market	dominance of NGOs	dominance of state
Role of state	loosely regulates, supervises	coordinates, supervises, organises	controlling, strongly regulating
About democracy	participatory, representative consultation of civil society organisations	participation with broad consultation of civil society organisations	majority representation, direct consultation

Source: author's compilation based on Torma 2010 and Kovács 2014

1.1. The technical approach and the NPM

The basic premise of the technical approach is that even the most complex social systems can be broken down into simple technical processes. And the nature of the workflows and activities that result from this decomposition do not differ between private and public administrations (Torma 2010).

Its axiomatic starting point is that reducing public spending and improving the quality of public services can be achieved by increasing market coordination and competition (Rosta 2012a). This approach has rapidly gained popularity, particularly in Anglo-Saxon countries. One reason for this is that while in continental Europe there was a strong control over public services, in the US the concept of a strong state had not developed (Peters & Pierre 1998). In the 1980s, the adaptation of the principles of the New Public Management orientation became very popular among OECD countries, and its proposals were also popular in post-socialist countries.

According to the NPM, in the former state institutions, politicians and officials were allowed to pursue their own interests, resulting in high costs and low-quality community services. This highlights the importance of accountability (Hood 1995). NPM emphasizes the need to outsource those public functions that can be performed by the private sector, thereby increasing operational efficiency (Lentner 2019). The ideology puts the focus of operations on increasing efficiency, but these risks make democracy core principle of the public sector rather than a core principle (Wise 2002). The goals and tools of NPM are summarized in Figure 2.

The New Public Management proposes to unbundle the public sector into smaller units, organised according to the tasks they perform, thus defining responsibilities more precisely. It also aims to increase competition between public sector organisations and between public and private sector companies. Furthermore, it promotes the adoption of private-sector practices and encourages the efficient use of resources, reducing central constraints while increasing the accountability of individual actors. There is also a strong emphasis on the need for standardised performance measurement and evaluation. With appropriate benchmarking the efficiency and accountability of the public sector can be increased (Hood 1995). NPM calls for the cooperation of the public and private sectors. One example of this cooperation are Public-Private Partnerships (PPP). It is a form of public-private partnership in which the parties share the responsibility and risk of providing public services. In such partnerships, the State entrusts the private sector with a greater or full and more complex role than is usually the case (Varga 2016) PPP is generally a long-term agreement, which makes the recovery of costly infrastructure services available for the private contractor (Péteri 2017). PPP contracts had a positive impact in Europe (Kirovotko 2017), however, some of the literature points out the disadvantages of the PPP (Báger 2006).

Figure 2

Goals and tools of NPM

Category	Goals	Examples
Organisational transformation	Delegation of responsibility Reducing the level of hierarchy Separating political and managerial roles	City Manager Holding structure
Management tools	Strengthening output orientation Developing an entrepreneurial spirit in public administration	Performance-based agreements Performance-related wages
Budgetary reforms	Promoting the use of techniques similar to those used in business financial instruments	Cost calculation methods Introduction accounting method similar to those used in business environment
Participation/Partnership	Involving the public in decision-making and in the preparation of decisions	Support for small community partnerships E-democracy Cooperation with NGOs
Customer Orientation/Quality Management	Increasing the legitimacy of the public sector by improving service quality	Service level-based contracts E-government
Marketisation/privatisation	Reducing the size of the public sector while increasing its efficiency through competition and market coordination	Privatisation Outsourcing PPP Public procurement

Source: Rosta 2012b

The NPM has confronted two major doctrines that pervaded the public sector. One was the differentiation between the public and private sectors. The other was a sharp separation of managerial and political actors, designed to prevent corruption and thus maintain public trust. The NPM would address accountability by breaking down these two principles, i.e., by reducing the differences between the public and private sectors and increasing accountability for the evaluation of results. A key element of this is the reform of accounting practices, i.e., the transfer of accrual accounting to the public sector (Hood 1995). The NPM assumes a competitive environment, dividing the population into smaller groups. Needs are not identified by experts, as in the Weberian state, but are assessed through the evolution of market needs, with a market and consumer-centered strategy (Hartley 2005). However, this assumes that society can assess its own preferences.

1.2. Value and participatory approach and the Good Governance

The core idea of the value and participation approach is that public decisions are not the prerogative of the bureaucracy but should be made with the involvement of stakeholders. In contrast to the NPM, the model puts the civil sector at the center, rather than the business sector. Decision-making is characterized by a search for a compromise and broad public consultation (Kovács 2014). The trend can be traced back to the World Bank's proposals in the 1980s (Pályi 2015).

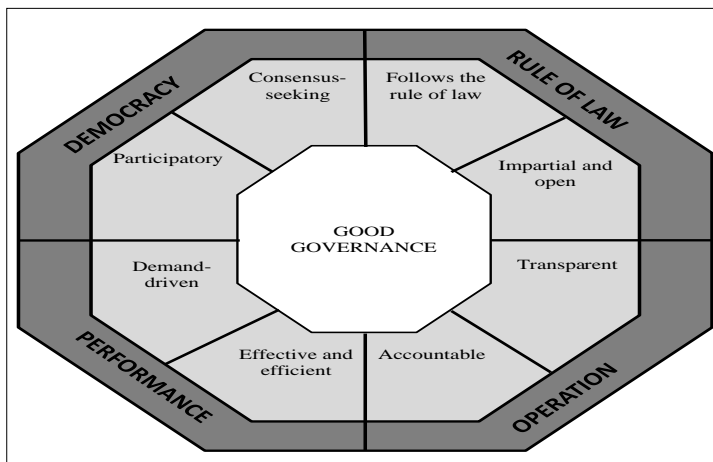
Good Governance is defined as a political and institutional environment in which human rights, democratic principles, and the rule of law are respected, Good Governance is based on transparent and accountable management of human, natural, economic, and financial resources (Vértesy 2014).

By involving stakeholders, ensuring transparency and accountability, the quality of governance can be improved. Within the framework of Good Governance, the state primarily uses the instruments of regulation, playing more of a mediating role between different social strata, and its allocative and redistributive role is more limited than in traditional models (Kovács 2014). The growing need to strengthen democracy also affects the design of institutions. Increasing transparency is a key element in supporting democracy. Coordination is seen as more society-centered (and thus less state-centered and market-centered) (Lynn 2008). Báger et al. (2010) suggest that the involvement of civil society in economic policymaking and its effective cooperation with the state can improve competitiveness.

A general characteristic of Good Governance, in compliance with the law and equal opportunities legislation, is that it is inclusive of others. It is consensual and encourages civil society to participate and cooperate. It is characterized by sound and efficient management and responsiveness. The government is accountable and transparent (Pályi 2015). The theoretical model of Good Governance is summarised in Chart 1.

Chart 1

Components of Good Governance



Source: Netherlands court of Audit 2014, 18

1.3. The regulatory approach and Neo-Weberian theory

The regulatory approach emphasises that the state must solve problems through regulation, by amending old rules or creating new ones. The focus on rule-making involves not just legislation but also the application and monitoring of the law. The regulatory approach emphasises the importance of the state and has the potential to steer the behaviour of citizens and organisations in the direction desired by the state. It can do this through the binding force of law and the enforcement of sanctions for violations, as well as through various incentives.

The concept is based on four principles. One (in contrast with the concepts presented in the previous subsections) is the centrality of the state. An important element is the renewal and application of the rules of public administration, the preservation of public services and representative democracy (Dunn & Miller 2007).

A significant change from the original Weberian concept is that it pays more attention to social needs in the design of the bureaucracy and that it encourages a managerial approach to bureaucratic compliance (a fundamental feature of Weberian philosophy) (Figure 3). This combination does not imply a mix of NPM and Weberian organisation, but rather the use of NPM elements that do not contradict the logic of Weberian state organization within the framework of Neo-Weberian public administration (Stumpf 2009). In this way, quality of services can be ensured, and real social needs can be met (Lynn 2008). Kuhlmann et al. (2008) argue that the Neo-Weberian approach can address the problem that arose when managerialist approaches were introduced. In the public spheres of continental Europe, rule-following had a much stronger cultural basis, so business practices could not really take root. The Neo-Weberian trend was able to emphasise the need to take culture and institutional context into account (Rosta 2012a), and to provide much greater openness to citizens (Pongrácz 2016).

Figure 3

Main features of the Neo-Weberian state

Weberian features	Neo-Weberian features
Strengthening the State's leadership in responding to globalisation, technological change and demographic and environmental challenges.	Internal orientation and a focus on bureaucratic rules rather than external orientation, with a focus on meeting citizens' needs and wishes.
Strengthening the role of representative democracy as the basis for the legitimacy of the state apparatus (at central, regional and local level).	Complementing representative democracy with means of consultation and direct expression of citizens' views.
Strengthening the role of administrative law as the basis for relations between citizens and the state, including equality before the law, legal certainty and detailed legal regulation of state interventions in social processes.	Modernising the legal system to ensure that resources within the administration are used in a results-oriented way rather than overly prescriptive. The focus of control is thus shifting from ex ante (input) control to ex post (output, outcome, impact) control.
Maintaining a well-defined status, culture and set of rules for the civil service.	The professionalisation of the civil service, which means that civil servants are becoming managers with professional competences in addition to legal expertise.

Source: author's compilation based on Rosta 2012a

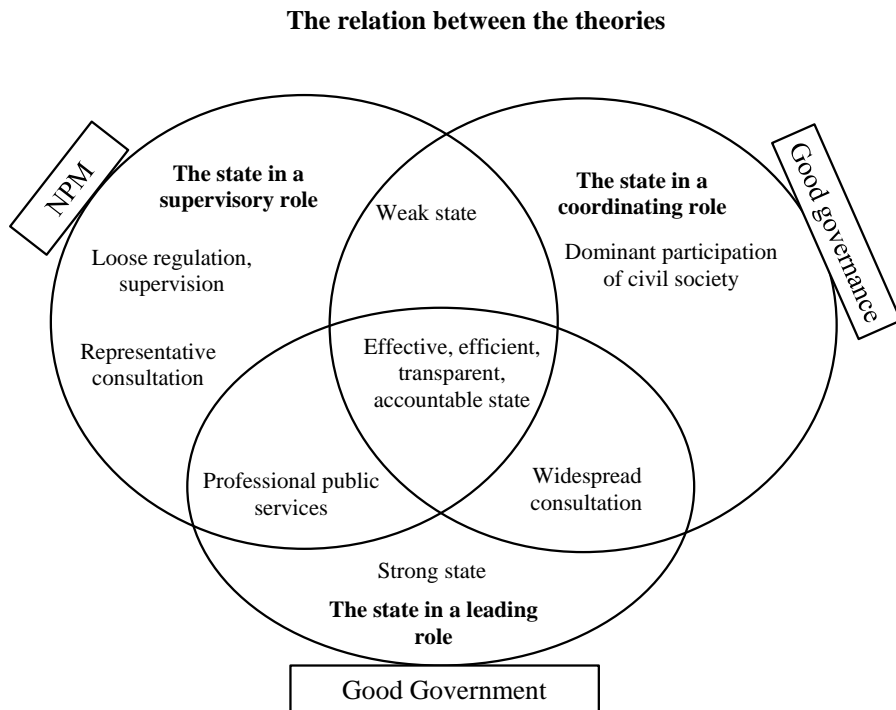
The potential risk of Neo-Weberian state organisation is that organisations may be diverted from their original purpose, thus calling into question their legitimacy. In addition, anti-democratic elements may often be present in the functioning of such state organisations (Lynn 2008). Critics of this tendency argue that the 'checks and balances' on government power may not function properly and that the weight of the institutions that represent it may be diminished (Kovács 2014).

1.4. The relation between the theories

Overlaps can also be observed between the three tendencies. Transparency, accountability, and controllability of the state are considered important by all approaches, and the methods used are very similar at the organisational level. Perhaps the most striking example of this is the emergence of accrual accounting in the public sector, which is supported by all three strands. The difference lies in the role of the state: the NPM seeks to reduce the role of the state, the neo-Weberian approach seeks to strengthen it, while the Good Governance approach emphasises the role of the state in coordinating between different groups of society. However, apart from the role of the state, there are many similarities between the neo-Weberian state and other trends

(Chart 2). There is an overlap between the theories of the state, but they are not completely contradictory. The ultimate goal is the same: to create an effective, efficient, transparent and accountable state.

Chart 2



Source: author’s compilation based on Tóth 2021, 218

The objectives set by the trends cannot be achieved without a properly structured and implemented accounting information system, which is why the development of an accounting system is an important element in any administrative reform.

1.5. How could the ultimate goals be defined?

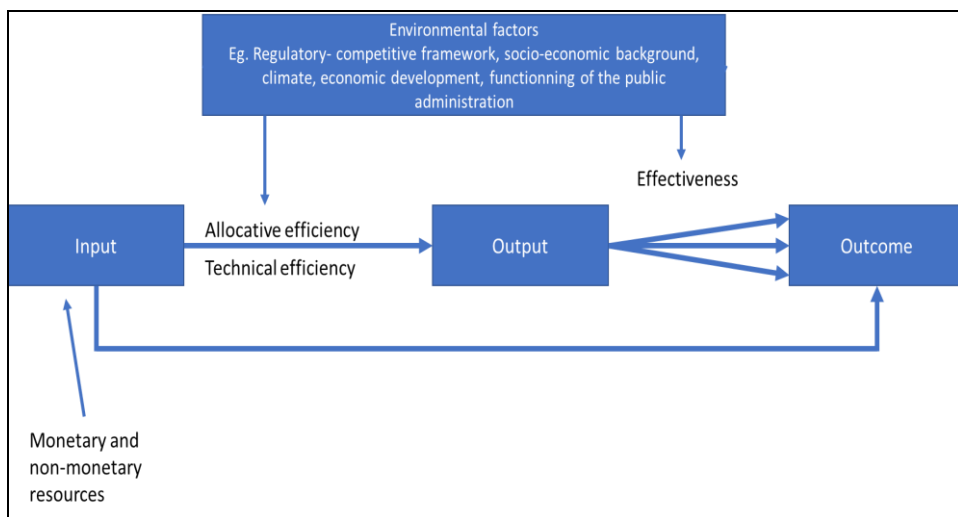
Transparency is understood as the requirement that the management of public funds should be accompanied by openness. In the principles of the State Audit Office of Hungary, great importance has also been attached to the control of the rules of the organised provision of tasks and the development of appropriate internal regulations. An important element of transparency is the timely fulfilment by organisations of their obligations to provide information and to disclose their public tasks as set out in their statutes. In addition, the organisation’s managers should establish a traceable system for the flow of information within and outside the organization, which can be operated appropriately and securely (Domokos 2015).

Efficiency can be defined as the ratio of outputs generated to resources used. So, first and foremost, there is a need to properly measure inputs and outputs, and to track which resources are created to support which activities. It should also be pointed out that it is more difficult to quantify and monetise the value of factors of production in the public sector than in the private sector, and the same can be said for outputs (Mihaiu et al. 2010).

Effectiveness is a concept closely related to efficiency (Chart 3). While efficiency is related to the ratio of outputs to inputs, effectiveness can be described as the relationship between outputs and the effects induced. In practice, however, it is often only possible to compare impacts achieved with inputs, making it difficult to isolate the two concepts. It is important to be aware that efficiency and effectiveness do not depend only on the organisation of the state but are also influenced by various environmental factors which are difficult to isolate in the analysis.

Chart 3

Relation of the efficiency and effectiveness



Source: Mandl et al. 2008, 3

In addition to effective and efficient management, accountability is also an increasingly important factor in public finance analysis. Accountability is the requirement that public officials and decision-makers must be responsible for the resources they use and the powers they have (Mulgan 2000). Accountability encompasses the legal framework, reporting obligation organizational structure, strategy, procedures, and activities that ensure that the organization fulfils its legal obligations within a defined framework, under its publicly funded public mission and accountability as defined in its founding document (Domokos 2015).

In other words, the accounting system of the state should support the efficient use of resources, control the process of its use, and enable the persons and entities that

control the resources to have adequate information. In addition, it should also support the process of comparing alternatives, which can be facilitated by the management accounting methods described earlier. It is therefore of great importance that public assets, in all their specificities, are properly valued and that the processes that give rise to changes in them are timely and accurately mapped. The requirement to be up-to-date thus becomes important. Therefore, public sector accounting has become a critical element in the functioning of public finances.

2. How could accounting support the ultimate goals?

As we can see, modern states must aim to be accountable, transparent, efficient, and effective. To reach these goals, an appropriate accounting system is indispensable. This section highlights the main benefits of the adoption of accrual accounting and suggests some areas it can support the public sector to meet with these objectives.

2.1. Characteristics of accrual accounting

Accrual accounting is the only comprehensively accepted information system that provides a complete and reliable image of the economic and financial position and performance of the government (or any organization). It can capture the assets and liabilities as well as the revenue and expenses of an entity in a certain period. Accrual accounting can create a more accurate image from the events of the economy because it entails the creation of entries whenever economic value is created, transformed, or extinguished, regardless of any payment, while cash accounting only records transactions when the payment is done (European Commission 2013). Accrual accounting is timely in recording the accrued revenues and expenses and authorizes the broad assessment of financial position or periodic financial performance (Christensen et al. 2018).

Accrual accounting shows how an organisation is financed and whether activities met their cash necessities, while also providing an opportunity to evaluate the entity's ongoing ability to finance its activities and to meet its liabilities and commitments. Accrual accounting is easier to understand for external users of the information than the particular public sector reports. It provides the organisation an opportunity to display successful management of its resources, and it is useful in the evaluation of its performance. These benefits also allow taxpayers to measure and control the needs for taxes (Salleh et al. 2014).

As accrual accounting can provide a more up-to-date picture, it creates more punctual data on the costs and develops the cost-accounting. It also supports the development of the management of intangible assets and helps the improvement of internal and external audits (Tóth 2020).

As a consequence, accrual accounting supports the transparency and the comparability of different economic organisations, and with the proper recognition of the costs supports the effective and efficient management of resources.

2.2. How can management accounting be relevant in the public sector?

But what do we mean by management accounting? Management accounting is the set of activities that enable information users to make informed decisions by identifying, measuring and communicating economic information. Managerial accounting also seeks to produce future-oriented information, primarily to meet the information needs of stakeholders within the organisation. In this way, management accounting can directly influence the preparation and making of decisions, planning, evaluation, and control of activities (Prowle 2021).

As with other aspects, the toolbox of managerial accounting must consider the differences between the public and corporate spheres. The main difference is that profits that may arise in public organisations cannot be interpreted as a positive in the same way as in private sector organisations. They may signal that a public service is overpriced, or the population is overtaxed, neither of which is conducive to the creation of the public good. All of these observations should also be seen in light of the fact that some public sector institutions also have very broad functions and thus operate differently. For this reason, even within the public sector, it is not possible to create a single management accounting information system, and modified approaches must be adopted. Furthermore, unlike private sector, the public sector is typically not able to segregate its activities and must perform its tasks even if it can only do so at a loss or with low efficiency. The main differences between the two sectors are summarised in Figure 4.

Figure 4

Public organisations versus private organisations

Public organisations	Private organisations
Are usually monopolies	Operating on competitive markets
Serve the citizens	Maximize the investment's profit
Are driven directly or indirectly by politicians, which should reflect the interests of the citizens	Leaders of companies are responsible to shareholders, to the boards; they seek profit maximization
State organizations are more rigid due to the process of decision making and implementation	Are more flexible, easier to manage because the decision is taken by a single leader
Distribute, redistribute, and regulate resources	Produce and distribute resources
Are sometimes poorly funded, more or less	Are financed by their own productivity or by investment if such a decision is feasible
Citizens are often poorly informed and suspicious of government	Investors and shareholders are well informed, and the ongoing activities of the company and the market evolve

Source: Mihaiu et al. 2010, 133

The above suggests that different types of decisions in the public sector are subject to different decision-making logics, despite the growing importance of different social considerations in the corporate sector (Mihaiu et al. 2010). A further problem is that services are typically not sold (or, put differently, have no direct market value), and the

use of public resources typically has multiple objectives in parallel (Mandl et al. 2008). As a consequence, effectiveness and efficiency may be interpreted in different ways and thus require different managerial accounting information than in the private sector.

Thus, the measurement of profit and revenue may not be considered obvious, but the proper measurement and management of the use of resources (hence the recording of costs) is more so. The assessment of the costs of each activity or organisation can play a major role in preventing excessive deficits, allowing comparability between institutions (cost centres) carrying out similar activities, and allowing the financial impact of changes in service provision to be monitored. It can also provide a good starting point for pricing public services (Prowle 2021). Adequate estimation of the costs of services can be an essential element of effectiveness and efficiency studies, which can help inform decisions on service delivery choices and closely related to this, support the budget planning process (Sisa & Veress 2014; Prowle 2021). The potential applications of cost information are summarised in Figure 5.

Mikesell (2006) has highlighted the importance of benefit-cost analyses to reduce waste of taxpayer resources (Mikesell 2006), but also the role of political factors in decision-making processes (Brorström 1998), and the possibility that accrual-based data may prove to be even less meaningful than other accounting information (Pollanen & Loisel-Lapointe 2012). Thus, the production of new data alone cannot improve efficiency.

Figure 5

Relevant areas for cost information in the public sector

Area	Description
Activity cost analyses	Cost information can be useful for determining the cost price of certain products or services, or for examining which activities generate losses. It can also be used to assess how an organisation's results change when it changes its output.
Budget reporting	An accurate knowledge of cost information is a major contribution to improving the quality of financial planning. Budgets become more predictable so that funding needs can be assessed more accurately.
Pricing	The pricing of public services is an important issue for public sector organisations. Although the purpose of pricing is fundamentally different from that of the corporate sector, estimating the value of the resources used to produce them and ensuring their return is not a secondary consideration.
Performance improvement and benchmarking	Changes in costs can be compared with the costs of other similar organisations. Such studies can help to improve organisational efficiency. This approach allows 'make or buy' decisions to be made, i.e., it can help to assess which activities are worth outsourcing and which are worth carrying out in-house.
Strategic financial planning	Cost information can help evaluate the impact of strategic decisions and organisational changes.

Capital investment appraisal	Public sector organisations also need to allocate capital for investment and new activities. A good understanding of costs is important for capital injections of a strategic nature, as well as for capital injections for operational tasks.
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Source: author's compilation based on Prowle 2021

2.3. Why does managerial accounting have a marginal role in the public sector?

Prowle (2021) also points out that there are several limitations to the inclusion of cost analyses. One reason is that public sector organisations mostly create services rather than products. Public services, by their very nature, have some of the fundamental characteristics of services, such as intangibility, inseparability, transience (services are not stockable), or variability in quality. These make it difficult to define the product to which costs are assigned (for example, in the case of a hospital, the relevant cost unit may be a patient, a disease or a treatment). Another problem is that services are typically labour intensive. In practice, however, it is difficult to attribute the actual labour used to a specific activity or output. In addition, the high value of indirect costs adds to the difficulties. Although cost allocation methodologies are typically defensible, in many cases they are not sufficiently sophisticated to accurately allocate indirect costs between activities.

The analysis of the range of input sources in the public sector is also complicated, and this is particularly the case for indirect costs and opportunity costs (Mandl et al. 2008). Nevertheless, the analysis of efficiency cannot be disentangled from the problem of determining the value of outputs. Similarly, the judgement of efficiency is also variable, as the effects of individual activities are strongly influenced by wider economic and social factors.

Accurate estimation of the costs of production is difficult even under the output approach. The assessment of the effectiveness and efficiency of activities is also hampered by the difficulty of linking individual revenues and costs to an output. Another problem is that public sector activities often have indirect social impacts that cannot be monetised. Examples include health services and education, where the monetary value of positive impacts (e.g., increasing healthy life expectancy) is difficult to assess, and many externalities should not be overlooked. Furthermore, private sector organisations are free to choose their activities, keeping the profit-making process, whereas in the case of the state, there is no such choice due to the social importance of public services, i.e., services must be provided even at a loss (Mihaiu et al. 2010).

Flury and Schedler (2006) labelled as impossible to design accounting systems that focus on costs and performance for the internal management of a purely profit-concerned organization. They point out that managers and politicians in organisations are interested in different types of information. Stakeholders in organisations tend to focus on the original, decision-support functions of managerial accounting elements, while politicians are specifically interested in the total cost of an activity. As the latter group also has a role in shaping the accounting system used, it may even deviate from the ideal in the theoretical accounting sense.

Nevertheless, there may be more practical reasons that prevent management accounting from becoming established in the public sector. For example, there may be a

lack of relevant training, or a lack of human resource capacity, which means that public sector organisations do not have the staff to deal with the tasks beyond the mandatory reporting. Moreover, there is no guarantee that even if relevant information is generated (or if it is compelled by regulation), it will be used in decision-making.

In conclusion, although the opportunities offered by management accounting are one of the most attractive arguments for the introduction of accrual accounting, it is an approach that is less usable in practice. In addition to the selection of appropriate management accounting methods, great attention should be paid to the selection of appropriate areas of application. Thus, it is too much to expect the reformed government accounting information system to be able to support a detailed assessment of each activity. As is the case in the corporate sector, management accounting in the public sector should not be extended to the whole organisation but should be focused on a single activity. This approach can be used to assess the effectiveness of an institution performing a similar function, or to assess whether it is worth outsourcing a particular activity or carrying it out by the organisations of the public sector.

Conclusion

In this study, we have seen that post-Weberian theories share several common features, despite their different ideological foundations. The most significant of these is the motivation to achieve transparency, accountability, effectiveness, and efficiency. These goals can only be supported by an appropriate accounting system. The literature reviewed agrees that the accrual approach can support these objectives.

It can produce more accurate information on the costs of individual activities by providing a reliable and realistic picture. This allows better decisions to be made and performance to be evaluated. However, in many cases these expected benefits are not realised due to different theoretical or practical reasons.

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