

The Paradox of Accrual Accounting Reform: Transparency, Complexity, and Misalignment in the Public Sector

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Abstract

The adoption of accrual accounting in the public sector has been widely promoted as a reform to enhance transparency, accountability, and efficiency. However, emerging evidence suggests a paradox in which these intended benefits are not consistently realised. This conceptual paper critically examines the negative effects of accrual accounting reform by synthesising existing literature across five key themes: evolution over time, theoretical frameworks, research methods, geographical contexts, and organisational settings. Drawing primarily on institutional theory, the paper develops an integrative framework that explains how external pressures drive the adoption of accrual accounting, often resulting in decoupling between formal compliance and practical use. It further identifies a critical source of misalignment at the asset level, where accounting treatment may not reflect the underlying economic intent, leading to distorted decision-making and governance outcomes. By linking macro-level institutional dynamics with micro-level accounting mechanisms, the study provides a comprehensive explanation of why accrual accounting reforms may produce unintended consequences. The paper concludes with practical recommendations aimed at improving the relevance, usability, and contextual alignment of accounting systems in the public sector.

Keywords: Accrual Accounting, Public Sector Reform, Institutional Theory, Decoupling, Accounting Misalignment, Governance, Public Financial Management, Mfrs 116 (Ias 16), Mfrs 140 (Ias 40), Decision-Making

Introduction

Public sector organisations worldwide are facing increasing pressure to demonstrate transparency, accountability, and efficient stewardship of public resources amid growing fiscal constraints, rising public expectations, and heightened scrutiny of government performance. In response, many governments have adopted accrual accounting reforms as part of broader public financial management modernisation initiatives. These reforms are

widely promoted as mechanisms capable of improving financial reporting quality, strengthening governance, enhancing long-term fiscal sustainability, and supporting evidence-based decision-making. Consequently, accrual accounting has become one of the most influential accounting reforms implemented globally within the public sector.

The global diffusion of accrual accounting in the public sector represents one of the most ambitious and far-reaching reforms associated with the New Public Management (NPM) movement. Since the 1980s, governments across OECD and emerging economies have transitioned from traditional cash-based systems to accrual-based frameworks, often guided by international organisations such as the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), and the International Public Sector Accounting Standards Board (IPSASB). This reform trajectory has been underpinned by the assumption that private-sector accounting techniques—particularly accrual accounting—can enhance transparency, accountability, and efficiency in public financial management (Hood, 1995; Hyndman & Connolly, 2011). By recognising economic events irrespective of cash flows, accrual accounting is expected to provide a more comprehensive representation of government financial position, thereby enabling improved decision-making and long-term fiscal sustainability (Christiaens et al., 2010; Moretti & Youngberry, 2018).

Despite the widespread adoption of accrual accounting, growing evidence suggests that many public sector organisations continue to experience governance challenges, reporting complexity, weak decision usefulness, and implementation difficulties. In several jurisdictions, accrual-based financial reports remain underutilised by policymakers and operational managers due to their technical complexity and limited alignment with organisational realities. Furthermore, the increasing reliance on valuation-based accounting treatments has raised concerns regarding transparency, comparability, and the risk of distorted strategic decision-making. These emerging concerns indicate that the effectiveness of accrual accounting reform cannot be assumed universally and therefore requires critical re-examination.

However, despite its widespread adoption and normative appeal, an expanding body of high-impact scholarship has begun to question the efficacy and appropriateness of accrual accounting in the public sector. Rather than delivering its promised benefits, empirical evidence increasingly points to unintended and adverse consequences. Scholars argue that accrual accounting introduces significant informational complexity, rendering financial statements less intelligible to non-expert users, including policymakers and elected officials (Lapsley et al., 2009; Hyndman & Connolly, 2011). This complexity is compounded by the reliance on subjective estimations—such as asset valuation, impairment, and depreciation—which can undermine reliability, comparability, and ultimately the credibility of financial reporting (Carlin, 2005; Pallot, 2001). Consequently, rather than enhancing transparency, accrual accounting may paradoxically obscure financial realities, thereby weakening democratic accountability (Barton, 2009; Christiaens & Rommel, 2008).

From an institutional theory perspective, the global adoption of accrual accounting can be interpreted as a form of isomorphic pressure, whereby governments adopt internationally legitimised practices to gain credibility rather than to improve substantive performance

(DiMaggio & Powell, 1983; Lapsley & Pallot, 2000). In many jurisdictions, reforms have been driven by coercive and normative forces—such as donor requirements, professional networks, and global standard-setting bodies—rather than by demonstrated local need or capacity. This has resulted in what several scholars describe as “decoupling,” where formal compliance with accrual standards coexists with limited practical utilisation in decision-making processes (Hyndman et al., 2014; Polzer et al., 2021). As such, accrual accounting often functions more as a symbolic tool of legitimacy than as an operational instrument of governance.

The organisational implications of this misalignment are significant because governments often invest substantial financial and institutional resources in implementing accrual accounting reforms, including system upgrades, consultancy engagements, valuation exercises, and staff training. Despite these investments, many public sector organisations continue to struggle with limited managerial utilisation of accrual-based information, operational complexity, and weak integration between financial reporting and strategic decision-making. Consequently, concerns have emerged regarding whether accrual accounting reforms genuinely improve governance effectiveness and public value creation or merely increase administrative and reporting burdens.

In addition to institutional misalignment, the adoption of accrual accounting poses significant organisational and economic challenges. Implementation requires substantial investment in systems, training, and technical expertise, often imposing considerable fiscal burdens on governments—particularly in developing and transitional economies (Chan, 2003; Cavanagh et al., 2016). Moreover, the conceptual foundations of accrual accounting—rooted in profit-oriented, entity-based reporting—may be inherently incompatible with the broader public sector mandate, which prioritises service delivery, social welfare, and intergenerational equity over financial performance (Barton, 2009; Broadbent & Guthrie, 2008). This misalignment raises critical questions regarding the relevance and usefulness of accrual-based information in guiding public policy decisions.

A further concern relates to the behavioural and decision-making implications of accrual accounting. Emerging evidence suggests that accrual-based systems may not enhance decision usefulness as intended, particularly where reporting complexity exceeds the informational needs and interpretive capacity of users. This can result in limited utilisation of accounting information in practice, weakening its role in informing managerial and policy decisions and limiting its expected contribution to fiscal performance and governance outcomes (van Helden & Reichard, 2019; Dorn et al., 2021; Gårseth-Nesbakk et al., 2025). These dynamics challenge the assumption that accrual accounting inherently promotes fiscal discipline and instead highlight the potential for opportunistic behaviour within complex reporting environments.

The practical effectiveness of accrual accounting reform, therefore, remains a critical concern because public sector financial systems are ultimately intended to support governance, resource allocation, policy evaluation, and strategic decision-making. When accounting information becomes excessively technical or disconnected from operational realities, its utility for policymakers, managers, and public administrators may be significantly reduced. As a result, the intended benefits of accrual accounting—such as improved transparency,

accountability, and fiscal discipline—may not be fully realised in practice. This raises important questions regarding whether current accounting reforms genuinely enhance public sector performance or merely increase procedural and reporting complexity.

Despite these growing critiques, the extant literature remains fragmented and insufficiently theorised. Much of the research has focused on implementation processes and technical challenges, with limited attention given to the systemic and long-term consequences of accrual accounting reforms. Furthermore, there is a notable lack of integrative frameworks that synthesise institutional, organisational, and informational dimensions to explain why accrual accounting may fail to deliver its intended outcomes. This gap is particularly salient in the context of ongoing global efforts to harmonise public sector accounting standards, where accrual accounting continues to be promoted as a universal “best practice” despite mixed empirical support (Brusca et al., 2015; Polzer et al., 2021).

In particular, this paper argues that a critical but underexplored source of governance distortion arises from the misalignment between accounting treatment and the underlying economic intent of assets within public sector organisations. While accrual accounting frameworks rely heavily on formal asset classifications, these classifications may not accurately reflect how assets are strategically utilised in practice, particularly in hybrid and multifunctional public sector environments. This conceptual tension has important implications for financial representation, asset governance, and strategic decision-making within public sector organisations.

In response, this conceptual paper advances a critical, theory-informed examination of the negative effects of adopting accrual accounting in the public sector. Drawing on institutional theory as the primary lens, complemented by insights from public value theory and information asymmetry perspectives, the paper develops an integrative framework that explains how and why accrual accounting reforms may produce unintended consequences. By shifting the discourse from normative advocacy to critical evaluation, this study makes three key contributions to the literature. First, it consolidates and extends existing critiques into a coherent conceptual model. Second, it highlights the conditions under which accrual accounting may undermine, rather than enhance, public sector governance. Third, it provides a foundation for rethinking accounting reform in a manner that is context-sensitive, institutionally grounded, and aligned with the broader objectives of public value creation.

This study is important for policymakers, public sector executives, regulators, accountants, auditors, and standard-setting bodies seeking to improve the effectiveness of public financial management reforms. The paper provides practical insights into how accrual accounting may unintentionally generate complexity, misalignment, and reduced decision usefulness when implemented without sufficient contextual adaptation. By critically examining these limitations, the study contributes toward improving accounting policy design, strengthening governance practices, and enhancing the alignment between accounting systems and public sector objectives. The findings are also beneficial for researchers and academics by providing an integrative conceptual framework that connects institutional pressures, accounting treatment, and governance outcomes within public sector organisations.

Discussion

The synthesis of the literature across the five analytical themes—evolution over time, theoretical framework, research method, geographical area of analysis, and research settings—reveals a deeply interconnected and path-dependent trajectory in the adoption and critique of accrual accounting within the public sector. Rather than representing independent strands of inquiry, these dimensions collectively shape how accrual accounting reforms are conceptualised, implemented, and evaluated, thereby influencing both scholarly understanding and practical outcomes.

To synthesise the institutional dynamics underlying accrual accounting reform, Figure 2 presents the pathway from external pressures to organisational misalignment.

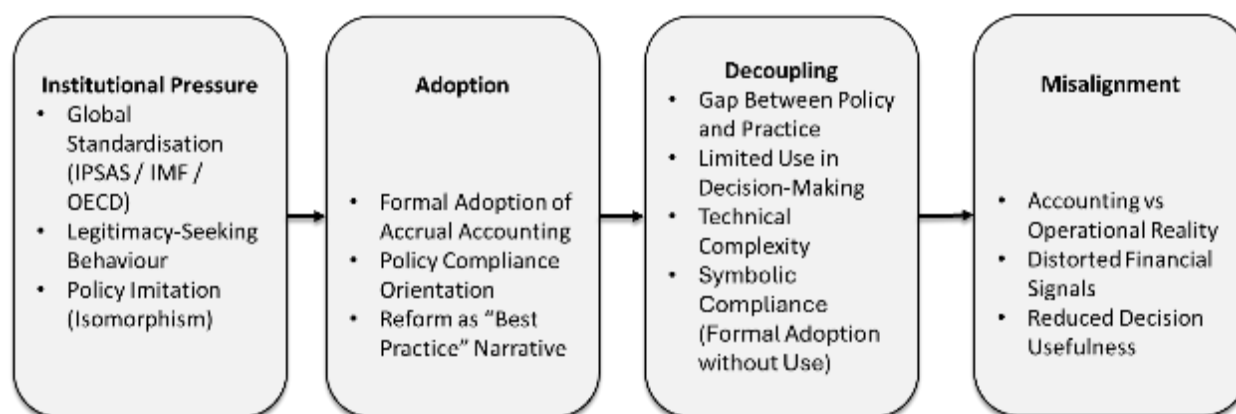


Figure 2: Institutional pathway of accrual accounting reform from external pressures to organisational misalignment in the public sector.

As illustrated in Figure 2, accrual accounting reforms are often driven by institutional pressures, leading to formal adoption that is not fully aligned with organisational realities, thereby resulting in decoupling and eventual misalignment in practice.

From an evolutionary perspective, the trajectory of accrual accounting reform reflects a shift from early normative enthusiasm to a more critical and reflective phase. Initial studies, largely situated within the NPM paradigm, framed accrual accounting as a technical advancement capable of resolving inefficiencies inherent in cash-based systems. However, as reforms diffused across jurisdictions and matured over time, empirical evidence began to expose inconsistencies between expected and realised outcomes. This temporal evolution has, in turn, influenced the field's theoretical framing. Early functionalist assumptions have gradually given way to more critical lenses—particularly institutional theory—which emphasise legitimacy, isomorphic pressures, and symbolic adoption. The interplay between evolution and theory suggests that theoretical advancements are not merely abstract developments but are responses to observed discrepancies in reform outcomes over time.

This theoretical shift has important implications for research methods employed in the field. Early research, often quantitative and prescriptive, sought to measure improvements in efficiency, fiscal discipline, or transparency following the adoption of accrual accounting. However, as critical perspectives gained prominence, there has been a noticeable transition toward qualitative and interpretive methodologies. Case studies, comparative analyses, and longitudinal designs have become more prevalent, enabling scholars to capture the complex

organisational and behavioural dynamics that quantitative metrics alone fail to reveal. This methodological evolution reflects a growing recognition that accrual accounting reforms are not purely technical interventions but are embedded within broader institutional, political, and organisational contexts. Consequently, research methods are increasingly aligned with theoretical frameworks that prioritise context, meaning, and process over universal generalisation.

The geographical distribution of research further reinforces this interdependence. Early adopters—primarily developed economies such as New Zealand, the United Kingdom, and Australia—served as empirical foundations for normative claims regarding the benefits of accrual accounting. However, as reforms extended to developing and transitional economies, the variability of outcomes became more pronounced. Differences in administrative capacity, governance structures, and institutional maturity have led to divergent experiences, challenging the notion of accrual accounting as a universally applicable “best practice.” This geographical expansion has not only enriched the empirical base of the literature but has also intensified the need for context-sensitive theoretical and methodological approaches. It underscores the limitations of transplanting models developed in one setting into fundamentally different institutional environments without adaptation.

Closely linked to geographical variation are the research settings in which accrual accounting is examined. Studies conducted at the central government level often emphasise macro-fiscal management and policy implications, whereas those focused on local governments, agencies, or specific sectors (such as healthcare or education) highlight operational challenges, resource constraints, and user engagement issues. These varying settings reveal that the impact of accrual accounting is neither uniform nor linear; instead, it is contingent upon organisational complexity, stakeholder capacity, and the intended use of financial information. The divergence across settings further complicates the evaluation of accrual accounting reforms, as outcomes observed in one institutional layer may not be replicable in another.

Importantly, the interaction among these five themes exposes a central tension within the literature: the misalignment between the theoretical promises of accrual accounting and its practical realities.

Accounting Treatment versus Economic Intent: A Source of Misalignment

A central yet underexplored issue in the critique of accrual accounting in the public sector lies in the misalignment between accounting treatment and the underlying economic intent of assets. While accrual accounting frameworks are designed to enhance transparency and provide a comprehensive view of financial position, their effectiveness depends critically on whether the applied standards accurately reflect how assets are actually used, managed, and valued within an organisation. This tension is particularly evident in the application of MFRS 116 (equivalent to IAS 16 Property, Plant and Equipment) and MFRS 140 (equivalent to IAS 40 Investment Property), which, although conceptually distinct, are often operationally blurred in public sector settings.

Under MFRS 116, assets are classified as property, plant, and equipment and are measured at cost, with depreciation applied systematically over their useful lives. This approach

assumes that the asset is held for operational use—supporting service delivery rather than generating direct financial returns. In contrast, MFRS 140 applies to investment properties, which are held to earn rental income or for capital appreciation and are typically measured at fair value, thereby reflecting current market conditions. Both standards are internally coherent within their respective frameworks; however, the challenge arises when asset classification does not align with the assets' economic functions in practice.

From an executive perspective, particularly in hybrid public sector organisations, assets frequently serve dual or evolving purposes. For example, land or buildings initially held for institutional or service-oriented objectives may later be repositioned as revenue-generating assets or strategic investments. In such cases, the continued application of MFRS 116 may lead to a systematic understatement of asset value due to historical cost accounting and accumulated depreciation. This not only affects the balance sheet but also distorts key financial indicators, potentially influencing strategic decisions related to asset utilisation, divestment, or redevelopment.

Conversely, the application of MFRS 140 allows for fair value measurement, which can provide a more accurate reflection of the asset's current economic potential. However, this approach introduces its own challenges, including valuation subjectivity and volatility, which may complicate financial interpretation for non-specialist stakeholders. The critical issue, therefore, is not the superiority of one standard over the other, but the appropriateness of the standard in relation to the asset's intended economic role.

This misalignment has broader implications for governance and decision-making. When accounting treatments fail to capture the true economic nature of assets, they can create informational asymmetries between financial reports and managerial realities. Decision-makers may either underutilise valuable assets due to understated valuations or misinterpret financial performance due to accounting-driven distortions. In public sector contexts—where accountability, transparency, and resource stewardship are paramount—such discrepancies can undermine both strategic planning and stakeholder trust.

Furthermore, the issue reflects a deeper structural limitation within accrual accounting frameworks: their reliance on categorical classification systems that may not adequately capture the dynamic and multifunctional nature of public sector assets. Unlike private-sector entities, where asset use is often more clearly defined by profit motives, public organisations operate under complex mandates that combine service delivery, social objectives, and financial sustainability. As a result, rigid adherence to predefined accounting categories may fail to capture the fluidity of asset roles over time.

Addressing this challenge requires a shift from a compliance-driven application of accounting standards toward a more intent-driven interpretation. Organisations should critically assess the purpose for which assets are held and ensure that accounting treatments reflect this purpose as closely as possible. This may involve periodic reclassification of assets, enhanced disclosure practices, or the adoption of supplementary reporting mechanisms that bridge the gap between accounting representation and economic reality.

In sum, the misalignment between accounting treatment and economic intent represents a significant source of distortion within accrual-based systems. It reinforces the broader argument of this paper: that the limitations of accrual accounting are not merely technical but are rooted in deeper conceptual and institutional mismatches. Recognising and addressing this misalignment is therefore essential for improving the relevance, reliability, and usefulness of financial information in the public sector.

To illustrate this mechanism, Figure 1 presents the conceptual pathway from accounting treatment to governance outcomes.

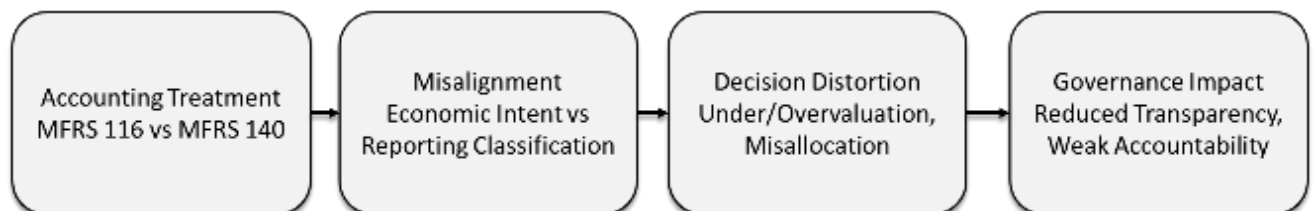


Figure 1: Conceptual pathway linking accounting treatment to governance outcomes in public sector organisations.

This asset-level misalignment provides a concrete illustration of the broader institutional and conceptual tensions discussed earlier, demonstrating how abstract reform assumptions translate into operational distortions.

The evolution of the field demonstrates that while reforms are often justified through universalistic and efficiency-driven narratives, their implementation is shaped by local institutional conditions, which are uneven and dynamic. Theoretical frameworks, particularly those grounded in institutional and critical traditions, help explain this misalignment by highlighting the role of legitimacy-seeking behaviour and symbolic compliance. Research methods have adapted accordingly, moving toward approaches that can capture these complexities, while geographical and contextual analyses reveal the limits of generalisability. The issue is not whether MFRS 116 or MFRS 140 is superior, but whether the selected accounting treatment reflects the asset's true economic purpose. In practice, applying MFRS 116 to assets functioning as investment vehicles may understate value and distort strategic decisions, whereas MFRS 140 offers a more decision-relevant perspective for assets managed for yield or appreciation.

Taken together, these relationships suggest that the negative effects of accrual accounting are not isolated anomalies but are systemic outcomes arising from the interaction of reform diffusion, institutional pressures, methodological limitations, and contextual variability. The persistence of these issues indicates that the challenges associated with accrual accounting cannot be addressed solely through technical refinement or incremental policy adjustments. Instead, they require a fundamental reconsideration of how accounting reforms are conceptualised, contextualised, and evaluated within the public sector.

This integrative understanding provides a foundation for advancing the paper's conceptual argument. It highlights the need to move beyond a one-size-fits-all approach to public sector accounting reform toward a more nuanced perspective that recognises the interplay between global standards and local realities. In doing so, it reinforces the central premise that accrual accounting, while theoretically robust, may generate unintended consequences

when transplanted across diverse institutional landscapes without sufficient adaptation or critical scrutiny. Collectively, this highlights a critical limitation of accrual accounting frameworks: their inability to dynamically capture shifting asset intent within hybrid organisational environments.

Practical Recommendations

Adopt a Hybrid Accounting Approach Where Appropriate

Public sector organisations should avoid a rigid, full-scale reliance on accrual accounting and instead adopt a hybrid approach that combines both accrual and cash-based systems. While accrual accounting provides insights into long-term financial position, cash-based reporting remains essential for budgetary control and liquidity management. Institutions should clearly distinguish the contexts in which each type of information is most useful, ensuring that decision-making is supported by relevant, practical financial data rather than driven solely by compliance requirements.

Prioritise Decision-Usefulness Over Compliance

Organisations should shift their emphasis from strict adherence to international accounting standards toward the practical usefulness of financial information. Reports should be simplified and tailored to the needs of policymakers and administrators, many of whom are not accounting specialists. This involves presenting information in a clear, accessible manner, aligned with operational priorities such as service delivery and cost management, while also regularly evaluating whether accrual-based data is actively utilised in decision-making.

Strengthen Institutional Capacity Before Full Implementation

Effective adoption of accrual accounting requires adequate institutional capacity. Governments and agencies should invest in training programs that equip both finance personnel and operational managers with the skills to interpret and apply accrual-based information. Implementation should be phased according to organisational readiness, as premature or forced adoption in low-capacity environments often results in superficial compliance without meaningful impact.

Reframe Asset Valuation Practices to Reflect Public Sector Realities

Asset valuation under accrual accounting should be critically reassessed to ensure its relevance to public sector objectives. Organisations should avoid excessive reliance on complex valuation models that offer limited practical value and instead differentiate between income-generating and service-oriented assets. Valuation practices should support strategic decision-making, such as asset utilisation and divestment, rather than merely fulfilling accounting requirements.

Align Accounting Systems with Public Sector Objectives

Accounting frameworks should be aligned with the broader goals of the public sector, which extend beyond profit generation to include public value creation and service effectiveness. Financial reporting should be integrated with performance management systems to ensure that financial data is meaningfully linked to operational outcomes. This alignment enhances the relevance of accounting information and supports more informed policy decisions.

Enhance Governance and Oversight Mechanisms

To mitigate risks associated with complexity and subjectivity, organisations should strengthen governance structures surrounding accrual accounting practices. Independent review mechanisms should be established for key estimates, such as depreciation and asset valuations, and supported by clear documentation and audit trails. Increased transparency in assumptions and methodologies will improve accountability and reduce the potential for manipulation or misinterpretation.

Customise Implementation Based on Organisational Context

A uniform approach to accrual accounting is unlikely to be effective across diverse public sector entities. Implementation strategies should be tailored to the size, function, and capacity of each organisation. Flexibility should be allowed to adapt to local conditions, and pilot programs should be conducted to test and refine systems before a wider rollout.

Manage Reform as an Organisational Change Process

The adoption of accrual accounting should be treated as a comprehensive organisational transformation rather than a purely technical upgrade. This requires active engagement with stakeholders, clear communication of objectives, and continuous monitoring of organisational responses. Addressing resistance and fostering buy-in are essential to ensuring that reforms translate into meaningful improvements in practice.

Establish Continuous Evaluation and Feedback Mechanisms

Organisations should implement ongoing evaluation processes to assess the effectiveness of accrual accounting systems. Feedback should be collected from users at various levels to identify challenges and areas for improvement. Continuous refinement based on real-world usage ensures that accounting systems remain relevant and aligned with organisational needs.

Avoid Over-Standardisation and Encourage Context Sensitivity

Regulators and standard-setting bodies should recognise the diversity of public sector environments and avoid imposing overly rigid frameworks. Instead, they should promote principles-based approaches that allow for adaptation to local institutional contexts. Encouraging flexibility and innovation in accounting practices will enable organisations to better align financial reporting with their specific mandates and operational realities.

Conclusion

This conceptual paper has critically examined the negative effects associated with the adoption of accrual accounting in the public sector, challenging its long-standing position as a universally beneficial reform. The discussion highlights that, despite its theoretical strengths, accrual accounting often introduces complexity, reduces transparency for non-specialist users, and creates misalignment with the core objectives of public sector organisations. These issues are further compounded by institutional pressures that prioritise legitimacy and compliance over practical utility, as well as by variations in organisational capacity, geographical context, and implementation settings.

The synthesis of the literature demonstrates that the limitations of accrual accounting are not isolated or incidental but are systemic in nature, arising from the interaction between

reform diffusion, theoretical assumptions, and real-world institutional constraints. The evolution of research—from early optimism to more critical and context-sensitive perspectives—reinforces the need to reassess how accounting reforms are conceptualised and implemented. Importantly, the findings underscore that accrual accounting, when applied without sufficient adaptation, may undermine rather than enhance decision-making, accountability, and governance.

For practice, this paper emphasises the necessity of repositioning accrual accounting as a flexible tool rather than a rigid standard. Public sector organisations must prioritise usability, strengthen institutional capacity, and align accounting systems with their broader mandate of public value creation. Looking ahead, future development should focus on designing context-sensitive frameworks, integrating financial and performance information, and exploring alternative or hybrid models that better reflect the unique nature of public sector operations.

Ultimately, advancing this agenda is critical to ensuring that accounting reforms genuinely support effective governance, strategic decision-making, and public value creation rather than merely fulfilling formal compliance requirements.

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