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Accrual Accounting Reform: A Learning Curve for Malaysia

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ABSTRACT

Background: Public sector reform is now initiated more aggressively under various terms of reference, such as transparency, better governance, and delivery efficiency and effectiveness. For Malaysia it is clearly motivated by both internal and external pressure to face the challenges and harnessing the global trend of change. Under current financial policy, both income and expenditure are clearly stated as the critical area of concern. Therefore Malaysian government is targeting accrual system to be fully implemented in its public sector by 2016. **Objective:** This paper examines the problems faced by the entity entrusted to be responsible to implement the accrual accounting in the public sector. **Results:** The findings showed that the shift towards accrual accounting demonstrates some problems in implementation such as recognition and valuation of assets and liabilities, human competency and, systems and technological development. These implementation barriers are among the reasons why developing countries should be cautious in considering accrual accounting reform. **Conclusion:** The adoption to accrual accounting will be a long challenge and it needs support from everyone to make it as a success with the hope for Malaysia to be one of the developed countries by 2020.

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INTRODUCTION

Migration from cash accounting to accrual accounting has been stipulated as one of the policy measures in the New Economic Model (NEM) as a mean to improve decision-making processes and strengthen public finance management of Malaysian public sector (Raja Abdullah, 2010). According to Datuk Wan Selamah, Accountant General of Malaysia, this will put the public sector of Malaysia in line with developed countries. On 11 May 2011, the Prime Minister of Malaysia mandated the implementation of accrual accounting by 2015 (Pasukan Pelaksanaan Perakaunan Akruan [PPPA], 2013). The implementation of accrual accounting will contribute to a more prudent fiscal management and can enhance the effectiveness of the financial management of the public sector (Accountant General's Department of Malaysia, 2013).

The journey towards accrual accounting has been challenging where commitment, full support and cooperation from everyone is needed to make this transition meet its objectives. Despite all the efforts put in place, the transition of management styles has always cause turbulence within the organization. The turbulence manifested thru internal

and external issues that might be hampered the flow of transition. Thus, a preliminary research study had been conducted to identify what are the problems faced by the policy executer in implementing accrual accounting in Malaysia. This paper reveals the importance of the research context in understanding the problems such as this. Implicitly, this paper explores the potential for conflict when management change took place, particularly from the discretion of the implementers in their interpretation of the problems arise.

The preliminary findings in this study showed that the main problem that disrupted the flow of transition is how the implementer ensures the level of knowledge and skills of the employees are sufficiently equipped to handle the new set of accounting regulation and information. The readiness of accounting information systems applications such as the software customization, systems familiarization and lack of equipment has a significant impact on the systems migration process. Besides that, issue in choosing the right accounting evaluation and recognition standards has slowing down the speed of the transition.

This paper starts with the revision of previous literature reviews about accrual accounting and the

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issues surround the development and implementation of accrual accounting in several countries. Then follow with findings and discussion and ended with conclusion.

Literature Review:

A new concept called New Public Management (NPM) that addresses the needs of efficiency, effectiveness, transparency and accountability of public sector (Pollitt, 1993, cited in Sevic, 2006; Guthrie, 1998; Ron and Mellet, 2003; Nistor *et al.*, 2009) has become a worldwide trend where accrual accounting is one of the reforms (Barton, 2005). Where its implementation is still widely discussed and argued among researchers, accrual accounting is often said it will improve efficiency and effectiveness of public management and lead to better decision making processes (Barton, 2005; Conolly and Hyndman, 2010).

In recent years, there has been a radical accounting reform in the public sector. The New Public Management (NPM) played a significant role in this reform which has led many public sector organizations to review their procedures and structures (Hood, 1995, cited in Arnaboldi and Lapsley, 2009). One of the reforms under NPM is adoption of accrual accounting which is believed to be able to provide more information for decision makers, lead to a better decision making (Conolly and Hyndman, 2010) and to enhance efficiency, effectiveness, transparency and accountability (Guthrie, 1998; Chan, 2003; Ron and Mellet, 2003; Barton, 2005; Nistor *et al.*, 2009; Monteiro and Gomes, 2013).

The adoption of accrual accounting is controversial and has been a subject of debate for many years. One of the major issues is the recognition and valuation of assets and liabilities (Hodges and Mellett, 2003; Chan, 2003; Marti, 2006; Saleh and Pendlebury, 2006; Lapsley *et al.*, 2009). It is hard to identify and measure heritage assets such as monuments and national parks; infrastructure assets such as roads; and military equipments. It is argued that assets such as public monuments should actually be regarded as liabilities because these assets are the subject of cash flows rather than inflows (Robert Mautz, 1988, cited in Lapsley *et al.*, 2009; Monteiro and Gomes, 2013). Furthermore, there are no agreed standards for recognition and valuation of those assets and liabilities (TironTuodr and Mutiu, 2006). As a solution, Government Finance Statistics Manual suggested the value of the insurance premium on the asset in question to be used while the UK has solved the issue by determining a nominal value for non-operating assets that were already owned while evaluating new acquisitions at their purchase price (Diamond, 2006, cited in Monteiro and Gomes, 2013).

Another issue is in regard to staffing or human competency. All staff that is used to cash accounting

might resist the new accounting system (Nistor *et al.*, 2009). A cultural change is needed in order to ensure the success of implementing accrual accounting (Monteiro and Gomes, 2013). Re-education and retraining of staff are needed to support the change (Gomes, 2013). Thirdly, the costs of implementation will be much higher and the efficiency of the new public sector system is still in question (Nistor *et al.*, 2009). The costs and benefits of the change are not necessarily well understood where it can result to an enormous wasted investment and a risk of losing financial control (Hepworth, 2003; Nesbakk, 2011).

Accrual accounting system as a medium in transforming public sector organization has been a popular alternative in recent 20 years (Wynne, 2004). Accrual accounting system, if it is to adopted in public sector, is said to be more transparent for decision making and performance management, as it has been employed in private sector structure that prioritizes profit, efficiency, effectiveness, in resource management (Pollanen & Loiseau-Lapoint, 2012; Taib & Mat, 1992).

To ensure the success of accrual accounting reform, Malaysia needs to look at the issues and concerns in adopting accrual accounting in public sector. The following section starts with a brief background about the problems faced by the Malaysian government in implementing accrual accounting systems. The discussion continued with the issues and challenges in adopting accrual accounting as experienced by others countries that had moved to accrual accounting are discussed and ended by conclusion.

Methodology:

In this research, a qualitative approach is considered as an appropriate method to investigate the research issues of this study. The aim for this research is to understand what are the problems faced by the Malaysian government while implementing accrual accounting, and how the strategies employed able to suppress the emerging issues. Thus, the process of "how" is unable to be solved only by searching on the surface, as Gillham (2000) commented, it needs "to get under the skin" of the organization to know what is really happening, and the informal reality which can only perceived from the inside. To view the reality from the inside, the researcher needs to see it from the perspective of those involved.

This approach requires data from various sources such as semi-structured and unstructured interviews, informal conversation, observation, review of internal documents, published reports or statements, and press releases (Yin, 2003). Several data collections strategies such as interviews and documentation reviews have enabled triangulation of the data and this provides a better understanding of the organization as a whole.

To advocate the research issue, Jabatan Akauntan Negara Malaysia (JANM) or General Accountant's Department was chosen as a subject of study due to its role as the primary government agency that directly involved in the implementation of accrual accounting in Malaysia. In ensuring the implementation process smoothly as it's planning, JANM has established Accrual Accounting Implementation Team (PPPA) to develop and implement Federal Government Accrual Accounting System in 2015 (PPPA, 2013a).

Since this research is a preliminary research, only two key officers were interviewed to capture the essential evidence of the main issues. One of them is a deputy director of accountancy development section at Accounting General Office. Meanwhile, the other interviewee is a head of assistant director of change management section. Both of them are the key officers that directly in-charged for the implementation of accrual accounting in Malaysia.

The research used semi-structured interviews since the method give a comprehensive idea or concept about the subject of inquiry. The main reference used to structure the main interview questions are derived from the Accountant's General Department accrual accounting strategic implementation plan. The strategic plan was used to validate whether is workable and if not what are the issues that hinder the process of executing the plan. The interview was conducted in April 2014 with one to one meeting session and the interview was conducted in English as the main medium of communication. The interview lasted about one to one and a half hours. In analyzing the data, the interview was transcribed and coded into thematic style of analysis.

Accrual Accounting in Malaysia- Problems Arised:

Issues and challenges are inevitable wherever change is instituted (Gomes, 2013). Despite the fact that many countries have moved to accrual accounting, objections and arguments continued to be raised by critics. One of the issues is accrual accounting is difficult to implement especially when bottom up approach is taken as it is difficult to push the political master from below (Ouda, 2013). According to Deputy Director of Accountancy Development Section, Accountant-General's Department (AGD), the recommendation of accrual accounting to be implemented in Malaysia has been proposed around 20 years ago but the attempts failed. The implementation of accrual accounting was made possible by the support from the Prime Minister of Malaysia after he announced the NEM (Raja Abdullah, 2010). This is supported by the Deputy Director of Accountancy Development Section, AGD as following comment:

We have been trying to implement accrual accounting earlier on but it has not been successful in the sense that earlier on, we tried to bottom up the

policy. From below, we have to push the political master which is very difficult. In fact, twice attempts were made. The first attempt was around 20 years ago, especially after New Zealand and Australia who had already implemented accrual accounting. There was an initiative where we visited all these countries who have implemented accrual accounting to explore the possibilities whether it is possible to implement it in Malaysia. The initiative was not successful. So, this would be the third attempt and it is successful in the sense that the policy is from the top down. The top down approach is easier where you do not have to convince them already.

Moreover, one of the major issues being discussed is the standards and procedures of valuation and recognition of assets (Mellett, 1997; Chan, 2003; Marti, 2006; Saleh and Pendlebury, 2006; Lapsley *et al.*, 2009; Monteiro and Gomes, 2013). It is difficult to identify and value heritage assets such as art and museum collections, public monuments, and national parks where the acquisition cost of these assets is unknown (Saleh and Pendlebury, 2006; Lapsley *et al.*, 2009). Malaysia is no exception to this where it is supported by the Deputy Director of Accountancy Development Section, AGD, as the following:

One thing is the difficulty of the records and cost information. A lot of assets don't have cost information. For lands and buildings, we will send it to the Valuation and Property Services Department for valuation.

In addition, there is no universally agreed approach on valuation of assets (Tiron Tudor and Mutiu, 2006). As a result, governments need to develop their own standards in those areas. Malaysia has also made a modification of international standards so it can be fitted and relevance with the Malaysian context, as mentioned below:

We are following International Public Sector Accounting Standard (IPSAS). There are 32 of them. Out of 32, we are going to adopt 30 standards and it will be converted as Malaysian Public Sector Accounting Standards (MPSAS). All of this IPSAS, if there is anything that we cannot follow, we will amend it. We got the approval from the IPSAS Board. (Deputy Director of Accountancy Development Section, AGD)

Another challenge in implementation of accrual accounting is the employees (Guthrie, 1998; Gomes, 2013). A cultural change of the employees is needed to ensure success in transition to accrual accounting (Monteiro & Gomes, 2013). All employees who need to move from cash accounting to accrual accounting may resist to change (Nistor *et al.*, 2009); especially senior employees. As per Malaysia experienced;

We already experienced resistance of change especially from senior staff in state level when we implemented Government Financial Management and Accounting System (GFMAS) (Head of

Assistant Director of Change Management Section, AGD)

Furthermore, the agitation towards the new system also poses a challenge for the conversion to accrual accounting. This statement is further explained by the Head of Assistant Director of Change Management Section, AGD with the following comment:

The employees are apprehensive of this change, but we are trying to emphasize that this is not a significant change. They are more concerned with the issues that will directly affect themselves such as if their workloads will increase and if the new system is difficult to use and many more.

Subsequently, the Deputy Director of Accountancy Development Section, AGD mentioned that the level of knowledge and skills of the employees also plays a significant role in ensuring the success of accrual accounting implementation. This poses a threat where the employees need to know the basic of the accrual accounting and the new system.

Apart from doing surveys, we have conducted dialogue sessions where we asked every ministry to send a representative from responsibility centers to discuss what are the problems or their concerns towards this change. One of the concerns raised by them was training. As our system is still in development phase, we cannot conduct the training yet.

Above all, the readiness of the employees is crucial for this reform to be a success. Their attitude and willingness towards the change are important as stated by the Deputy Director of Accountancy Development Section, AGD:

The second important thing is the readiness of the staff. Attitude of the staff and the willingness of them to move are very important. If they have the knowledge but do not want to accept the change, it will cause a big problem.

Apart from that, the issue of readiness also extends to the stakeholders. Their readiness also plays an important role where stakeholders such as the auditors will involve directly with the change from cash accounting to accrual accounting (Blondal, 2003). If the auditors are not ready, they will not be able to catch up and thus, hinder the success of the accrual accounting implementation. Hence, an agreement between the implementer and the auditors are achieved as commented by the Deputy of Accountancy Development Section, AGD:

Definitely we have a session with National Audit Department (NAD) and we get them involved in setting the accounting standards like determining the opening balance of assets and liabilities. We make sure that they agree to our matter, transitional approach. We are not going to take in all assets and liabilities in one go. This is the approach engagement with the auditors and it is one of the critical success methods.

Additionally, another challenge in the adoption of accrual accounting is system or technology (Guthrie, 1998; Blondal, 2003). The major problem associated with system or technology is time constraint. In order for the implementation of accrual accounting to take place, the new system based on accrual basis should be completed to facilitate the transition and hence, the training can be conducted. This is both supported by the following comments:

The new accrue based system is called IGFMAS. We outsourced to Innovation Associates Group System Integrator (IA) to develop the new system. They are our system integrator (SI). The system is in the midst of development, which is a bit delayed. We are hoping we can catch up. (Deputy Director of Accountancy Development Section, AGD)

Discussion: The Issues and Challenges:

The move to accrual accounting has not been accepted universally as many have failed in implementing accrual accounting in their public sectors (Tiron Tudor & Mutiu, 2009). As of today, there are significant discussions and arguments around the application of accrual accounting in public sector. One of the debates is accrual accounting is unsuited to the public sector due to the differences in objectives and character of economic decision-making between public and private sectors (Rowles, 2004; Nistor *et al.*, 2009). Most government services are not evaluated based on profits earned or losses unlike private sector. The accrual accounting standards have not been adequately suited to the unique environment of the public sector and the information generated might not be relevant to the needs of the public sector; thus, making it difficult to be understood and interpreted (Barton, 2005).

A major issue in the adoption of accrual accounting is the recognition and valuation of assets and liabilities (Hodges and Mellett, 2003; Chan, 2003; Marti, 2006; Saleh and Pendlebury, 2006; Lapsley *et al.*, 2009). Heritage assets such as monuments and national parks; infrastructure assets such as roads; and military equipments are hard to identify and measure. It is argued that assets such as public monuments should actually be considered as liabilities because these assets are the subject of cash flows rather than inflows (Robert Mautz, 1988, cited in Lapsley *et al.*, 2009; Monteiro and Gomes, 2013). As a solution, Government Finance Statistics Manual suggested the value of the insurance premium on the asset in question to be used while the United Kingdom has solved the issue by determining a nominal value for non-operating assets that were already owned while evaluating new acquisitions at their purchase price (Diamond, 2006, cited in Monteiro and Gomes, 2013). New Zealand and Australia generally resolved this issue by using a net current value approach to the valuation of assets

(IFAC, 1994). Using this approach, the balance sheet portrays the economic reality of the financial position more fairly (IFAC, 1994).

Chan (2003) stated that it is difficult for governments to recognize and measure its contractual or legal obligations and social responsibilities for the general welfare. Under cash budgeting, future liabilities are not accounted and therefore, the budget figures are not accurately reflected and it propelled New Zealand and Australia to adopt full accrual accounting with accrual budgeting system in order to have asset of financial statements that reflect a more accurate financial position of their governments. Actuarial and accrual methods are used by both New Zealand and Australia to account for future liabilities incurred under government employee pensions and government loans (Champoux, 2006). Meanwhile in 2012, US state and local governments with defined benefit pension plans were required to disclose a net pension liability on their balance sheet after the Governmental Accounting Standards Board (GASB) issued a new pension accounting and reporting standard that year (PwC, 2012).

Apart from valuation and recognition issue, there is a concern in using two different systems which is maintaining cash budgeting after the introduction of accrual accounting. It is not recommended because of compatibility problems that might arise with the information from the accounting and budgetary documents due to conflicting goals of the accrual and cash regimes (Monteiro and Gomes, 2013). In Canada, the departments were required to implement a common chart of accounts and submit monthly trial balances to the new central accounting system while their old set of accounts was still maintained for internal purposes (Pollanen & Loisel-Lapointe, 2012). Consequently, financial reporting and management decisions continued to be based on cash accounting or modified cash accounting as before. Pollanen & Loisel-Lapointe (2012) added that the use of dual systems often leads to conflicting and confusing data that discourage the managers from fully using the accrual system.

Another challenge in shifting towards the accrual accounting in public sector is in regard to staffing or human competency (IFAC, 2013). All staff whom are used to cash accounting might resist the new accounting system (Nistor *et al.*, 2009). Blondal (2003) stated that government accountants need to be trained and improve their skills in accrual accounting as they have been trained for cash basis of accounting. A cultural change such as re-education and retraining of staff are needed in order to ensure the success of implementing accrual accounting (Monteiro and Gomes, 2013). New Zealand Institute of Chartered Accountants (NZICA), previously known as the Institute of Chartered Accountants of New Zealand comprises of practicing accountants, corporate accountants and

public sector accountants gave support towards the reform process where they showed great effort in organizing conventions and forums related to the reform (IFAC, 1994). As of today, Malaysia's Accountant General's Department is actively conducting awareness and training programmes such as IPSAS workshops and MPSAS (Malaysian Public Sector Accounting Standards) workshops to help the employees for the transition to accrual accounting which will be commencing in 2015 (AGD, 2014).

Nistor *et al.* (2009) and Saleh & Pendlebury (2006) also argued that the costs of implementation will be much higher. The costs and benefits of the change are not necessarily well understood where it can result to an enormous wasted investment and a risk of losing financial control (Hepworth, 2003; Nesbakk, 2011). According to IFAC (1996), the costs of developing information systems can be very costly as the governments need to adopt a number of new processes in the effort to move from a cash-based system to an accrual-based system. It also involves human cost where the costs of staff retraining and sometimes the recruitment of new staff can be costly to ensure successful transition (Montesino & Vela Bargues, 1996). They added that these costs consist of acquisition of new computer hardware and system development cost which will require an investment of significant financial resources from the governments. This is supported by Cangiano (1996) where he had written about New Zealand experience in adopting accrual accounting where the country had incurred higher administration expenses and also faced additional spending by Inland Revenue to meet the implementation costs of various tax reforms.

It is indisputable that public sector accounting reform poses some challenges and to what extent accrual accounting reforms are responsible for economic growth and fiscal discipline remain unclear (Hepworth, 2003; Champoux, 2006; Zakiah & Pendlebury, 2006).

Conclusion:

Some researchers claimed that the reforms in the two pioneer countries as a success while some other researchers argued whether accrual accounting reforms are responsible for economic growth and fiscal discipline of those countries (Hepworth, 2003; Champoux, 2006). Nonetheless, the experiences of countries that have fully implemented accrual accounting such as New Zealand, Australia, United Kingdom and many more can assist any other country that is moving towards the accrual accounting adoption. Both countries can be said to be successful in achieving their objectives as they have demonstrated improved fiscal performance and better in managing their assets since the adoption of accrual accounting.

However, it is important for developing countries such as Malaysia to consider the issues or

challenges in implementing accrual accounting in order to ensure a successful of migration towards accrual accounting. In Malaysia especially, the challenge to have sufficient qualified staff is likely to be of more importance compared to the developed countries. Still, it can be learned from past experiences that the change can be done but the journey towards the goal may not be easy. With the will of the government for Malaysia to be a developed country by 2020, the change is not impossible to be made.

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