

Issues, Challenges and Recommendations in Complying to the International Accounting Standard (IPSAS) 17 on Property, Plant and Equipment¹

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<https://doi.org/10.58458/ipnj.v03.01.01.0026>

Abstract

The objectives of this study are two-fold. Firstly, it aims to highlight key issues and challenges in complying to IPSAS 17 on Property, Plant and Equipment (PPE). Secondly, the paper offers possible recommendations for resolving the identified issues and challenges in ensuring better compliance to IPSAS 17. In achieving the objectives, focus group discussions have been conducted involving panels from various organizations. The major issues discovered are related to the recognition/derecognition, measurement at/after recognition and disclosure of PPE assets. In resolving the identified issues, improvement of policies, guidelines, standards, asset management system and human capital are recommended. The findings of the present study are useful to relevant authorities such as National Accountant Department, National Audit Department and government servants' incharge of PPE in dealing with issues on recognizing, measuring and reporting of PPE items in accordance to IPSAS 17, to ensure smooth transition to accrual accounting by the year 2015.

Keywords: IPSAS 17, issues and challenges, accrual accounting, property, plant and equipment.

1.0 Introduction

Accrual accounting is an accounting basis for providing an accurate and transparent report concerning the government's position and performance. Currently, several countries, including Canada, New Zealand, the United Kingdom and Australia, have adopted accrual accounting. Accrual accounting recognizes and reports business transactions and events when they occur. In addition, accrual accounting accounts for all assets and liabilities. All the transactions are reported within the same period of the financial statement (Saleh and Pendlebury, 2006).

The transformation from modified cash accounting to accrual accounting focuses on more efficient and effective fiscal management. There are several advantages of using accrual accounting. By adopting accrual accounting, it is possible to practise transparency in respect

¹ This article is based on a research project in 2012-2013, funded by the Accountant General's Department of Malaysia.

of the government's financial management (Salinas, 2002). The recognition and recording of assets, liabilities, accounts receivable and accounts payable can provide a more rational insight into the financial position of the government. The stakeholders especially the citizens can assess the government's transparency and accountability in respect of its financial management, particularly the use of government funds and allocation of resources, through the information provided in the statements concerning its financial position and performance (Saleh and Pendlebury, 2006).

Accrual accounting can increase the sustainability of the organization by providing more complete and comprehensive financial and accounting information, which can assist decision makers (Barton, 2007). Foreign investors need to know about the financial position and performance of the government in order to attract them to invest in Malaysia. The implementation of accrual accounting enables the management of the financial sustainability of the national economy and ensures more coherent and comprehensive reporting in the financial statements. The important information about the financial position can be conveyed to the stakeholders through the recognition as well as recording of assets and liabilities. The government has immovable assets of high value, such as infrastructure, land and buildings, which could generate revenue for it and contribute to the economic development of the country. Information related liabilities, such as debts and loans, can provide an overview of the government's financial sustainability in respect of how funds are used to cover its obligations (Barton 2009).

Accrual accounting with comprehensive cost information (total) allows for the more effective and efficient measurement of the effects of policies in line with the objectives of the outcome based budgeting (OBB). In addition, the provision of additional funding sources for the implementation of programmes and activities that have a high impact on the Government can be made. Accrual accounting can provide an overview of the financial position and performance of the Government – whether it is good and efficient or vice versa (Hyndman and Connolly, 2011). A comprehensive presentation of the financial statements and a better performance indicator in financial management can provide more accurate and effective decisions. The performance and financial status of the ministries/departments can be measured by using the same standards. Accrual accounting promotes integrity by improving the efficiency, accountability and transparency in the financial and accounts management (Ball and Pflugrath, 2012).

Realizing the benefits of accrual accounting, under the Economic Transformation Plan (ETP) of the government, Malaysia will fully implement accrual accounting in the year 2015. Accrual accounting involves the recognition and recording of assets and liabilities, a centralized system with a single database, integrated with the main systems, such as e-Procurement, Project Monitoring System (PMS), Human Resources Management Information System (HRMIS), Outcome Based Budgeting (OBB), and other systems to comply with the Malaysian Public Sector Accounting Standards (MPSAS), which were adapted from the International Public Sector Accounting Standards (IPSAS). The preliminary transition to accrual accounting was implemented from 2011. Among the actions involved are a review of the Federal Constitution,

the Financial Procedure Act 1957, other Acts, policies, change management, design and development of the system.

Gearing towards full adoption of accrual accounting, one of the government strategies in implementing the accrual accounting system in Malaysia is in establishing relevant policies and standards. The *Government Accounting Standard Advisory Committee* (GASAC), which comprises the selected head accountant from the ministry, state treasury, representative of the statutory body, and representatives of professional bodies and universities, were established to review, enact and approve the policies and standards for accrual accounting. One of the important standards which has been established is the Malaysia Public Sector Accounting Standard (MPSAS) 17 which has been closely referred to the International Public Sector Accounting Standard (IPSAS) 17 on Property, Plant and Equipment. Hence, the present paper aims to focus on IPSAS 17, particularly on the issues and challenges for the government in complying to the standard. Also, this paper offers recommendations in resolving the potential issues and challenges.

The remaining of this paper is structured as follows. The next section (Section 2) briefly describes on the IPSAS 17. This is followed by Section 3 on the research methodology in carrying out the present study. Then, Section 4 discusses on the issues and challenges in complying to IPSAS 17 and Section 5 provides recommendations to resolve the issues. Finally, a concluding remark is presented in Section 6.

2.0 IPSAS 17- Property, Plant and Equipment

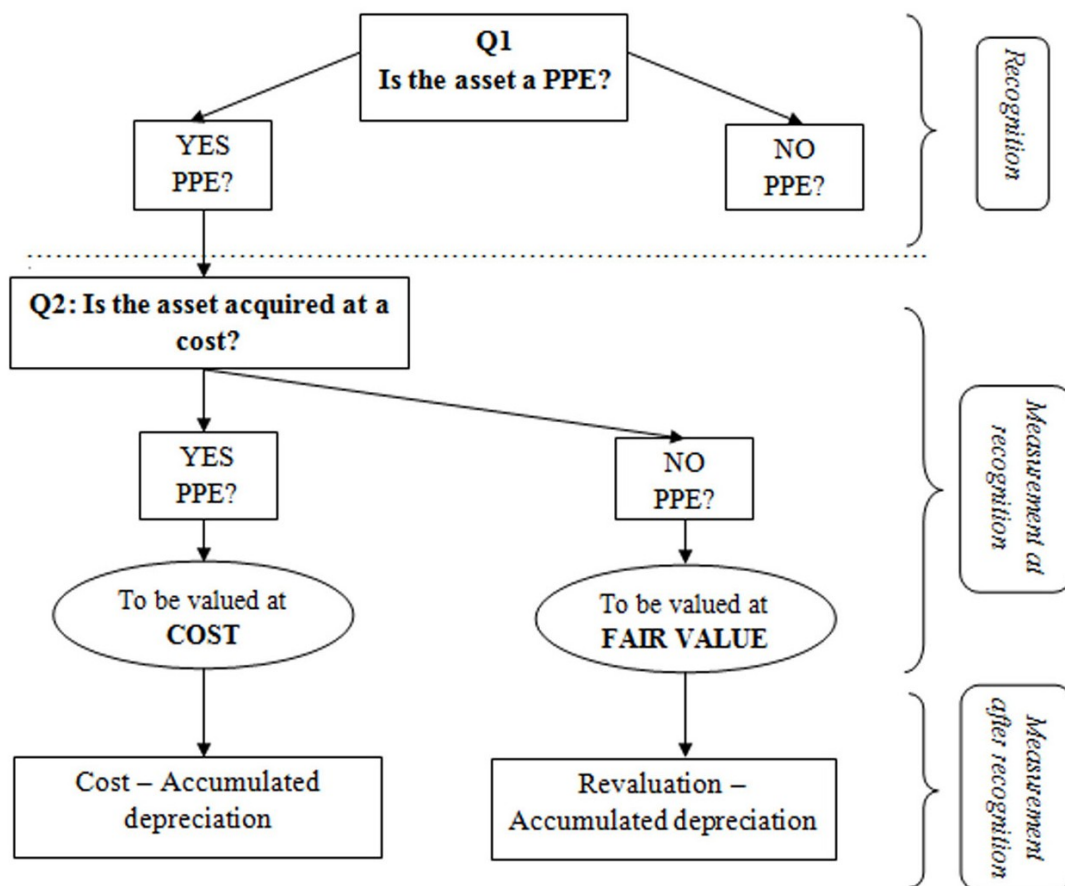
The International Public Sector Accounting Standards Board (IPSASB) has published IPSAS 17 on Property, Plant and Equipment December 2001. Until recently, the standard (i.e IPSAS 17) has been revised for several times with the latest revision issued in January 2011. The issuance of IPSAS 17 aims to provide information on accounting treatment for property, plant and equipment of a government's entity based on accrual basis. The standard covers three main areas of treatment that are: 1) recognition of the PPE; 2) measurement or determination of PPE's carrying values; and 3) depreciation and impairment of the PPE.

An article by Ismail et al. (2012) published in an earlier issue of IPN Journal of Research and Practice in Public Sector Accounting and Management offers a framework for recognition, measurement and reporting of government's property, plant and equipment based on accrual accounting which closely refers to IPSAS 17. In line with IPSAS 17, the proposed framework covers the important aspects of accounting treatment for PPE namely recognition of PPE, measurement at recognition, revaluation and depreciation of PPE as well as reporting and disclosure of PPE item (Ismail et al., 2012).

Figure 1 and Table 1 below provide a summary for recognition and measurement of PPE items as outlined by IPSAS 17 and captured in the framework by Ismail et al. (2012). In

relation to reporting and disclosure of information on PPE items, depreciation and impairment of PPE are recorded in the Statement of Financial Performance whilst gain or loss on PPE revaluation is reflected in the Statement of Changes in Net assets/ Equity. The value of PPE assets of a government entity is reported in a specific line item called property, plant and equipment under the category of non-current assets of the Statement of Financial Position (IPSASB, 2011a and Ismail et al., 2012).

Figure 1: Framework for Recognition and Measurement of PPE Assets



Adopted from Ismail et al. (2012)

Table 1: Interpretation to Figure 1 on the Framework for Recognition and Measurement of PPE Assets

	Answer	Qualifying criteria	Treatment / outcome
Q1	YES	1. It is probable that future economic benefits associated with the item will flow to the entity; 2. The cost or fair value of the item can be measured reliably	It is a PPE item and to be treated according to IPSAS 17.
Q2	YES	It is acquired at cost	Measurement at recognition is at COST. Subsequent measurement/ Carrying value: Cost minus accumulated depreciation
	NO	It is not-acquired at cost	Measurement at recognition is at fair value. Subsequent measurement/ Carrying value: Revalued amount minus accumulated depreciation.

Adopted from Ismail et al. (2012)

3.0 Research Methodology

In achieving the objectives of the study that are to explore the various issues, problems and challenges in complying to IPSAS 17 on PPE in the Malaysian context and to offer possible recommendations to overcome the issues, two sessions of focus group discussion were carried out. Focus group discussion has the advantage of allowing several relevant panels/experts to interact and express their views on the subject matter. In addition, focus group also allows researcher to observe the body language of the participants when expressing their views. Each of the focus group sessions lasted for two to four hours. The first focus group discussion involved four panels, two from the Accountant General's Department and two from the MOHE. The second focus group discussion was conducted in December 2012 with the similar objective of identifying the issues and challenges and potential recommendations to resolve the issues. The participants in the discussion of the second sessions comprised seven panels with different expertise but with experience relating to accrual accounting and PPE assets. Specifically, the panels were from the Accountant General's Department, Audit General Department, Ministry of Higher Education, a public university and a private accounting and auditing firm.

To ensure the systematic flow of the discussion, the chairman of the session ensured discussion on the issues and recommendations covering each of the three elements of

accounting treatment for PPE – recognition, measurement and disclosure of PPE assets. The participants were encouraged to give opinions, comments or post questions to other panels throughout the session. The discussions were tape-recorded, transcribed and analysed accordingly. The following sections present the outcomes from the focus group discussions in terms of the issues and challenges in adopting IPSAS 17 and recommendations to resolve the issues.

4.0 Issues and Challenges in Complying to IPSAS 17

The issues and challenges are categorized and presented under three main sub-headings namely; (1) Recognition/ derecognition of PPE Assets; (2) Measurement at (after) recognition; and (3) Reporting and disclosure.

4.1 Recognition/Derecognition of PPE Assets

4.1.1 Inconsistency in Asset Recognition

One of the issues in recognizing a PPE asset is inconsistency in the criteria for recognizing an asset (i.e. PPE). According to Paragraph 14 of IPSAS 17, an item of property, plant and equipment shall be recognized as an asset if, and only if it is probable that future economic benefits or service potential associated with the item will flow to the entity, and the cost or fair value of the item can be measured reliably.

However, at present the Government is using the definition of assets as stated in two government documents – the *Dasar Pengurusan Aset Kerajaan* and the Treasury Circular No.5/2007. The two guidelines define asset as “property belongs to or owned or controlled by Government either through buying, leased using Government money, received from contribution or present or get it through law process” (*Dasar Pengurusan Aset Kerajaan*: para 4 and *Tatacara Pengurusan Aset Alih Kerajaan*, Treasury Circular No.5/2007: para 2, 2007). In particular, according to the *Dasar Pengurusan Aset Kerajaan*, there are two categories of government assets: (1) moveable assets and (2) immovable assets. The moveable assets are assets that can be moved from one place to another and also include assets that are attached to a building, such as machines, vehicles and furniture. In contrast, immovable assets are static assets that cannot be moved from their location. Examples of immovable assets include land, infrastructure and buildings (*Dasar Pengurusan Aset Kerajaan*: para 3.4).

In other words, the definition, as stated in the documents (guidelines), only emphasises the aspect of asset management and ignores the economic viewpoint of an asset. The inconsistency in the definition of assets based on the accounting standards (i.e. IPSAS 17) and the government circulars and documents, to some extent, leads to the problem in recognizing an asset (particularly a PPE item) when accrual accounting system is being implemented.

4.1.2 *Shared Ownership Between Ministries*

Under the current practice, the Department of the Director General of Land and Mines (Federal) is responsible to register and to keep a record of federal government land. A piece of land is sometimes occupied by more than one ministry. When accrual accounting is implemented, there is a potential that the asset (i.e. land) will be recorded in two accounts, which leads to double counting (overstatement) of government assets. The issues are: (1) In whose account should the item be recorded? (2) If each sharing ministry is to record the land, what should be the value of the asset (i.e. land) recorded by each ministry?

4.1.3 *Appropriateness of Capitalization Threshold*

The rationale for setting the capitalization threshold is mainly because of the high volume of government transactions relating to assets. Many countries, as well as companies in the private sector, have also set the threshold to capitalise a transaction. As stated in a document by IFAC called Study 14 (IFAC, 2011), the capitalization threshold is subject to the controlling entities and may vary between jurisdictions. An example given in Study 14 is to set the requirement reported in the financial statements at a certain percentage (for example, at least 95%) of the estimated total assets by value. It is important to have a clear justification or criteria for determining the capitalization threshold. In the context of the Malaysian Government, the current capitalization threshold is RM1,000. However, a threshold of RM10,000 will be used when implementing accrual accounting in 2015. There has been concern as to whether the capitalization threshold of RM10,000 is appropriate.

4.1.4 *Lack of Competent Staff*

In recognizing a PPE asset, it is crucial that the staff in charge of keying in data for a transaction into the system have sufficient accounting knowledge to correctly record the transaction, particularly if it requires a decision to either capitalize or expense off. For instance, the maintenance cost for building can be operating expenses (Voting code OS28000) while some of the expenses should be capitalized (Voting code OA30000) because it will extend the useful life of the asset. Based on the present study, the majority of the staff who are responsible to key transactions into the system have insufficient knowledge and qualification to correctly record the transactions, which, ultimately, may lead to financial statements that do not reflect the true value of the government's financial position (i.e. total assets).

4.1.5 *Inefficiency of Asset System*

The current system to record immovable assets called 'Sistem Pengurusan Aset Tak Alih Kerajaan' (MySPATA), which was developed and maintained by the Malaysian Public Works Department, and is used by all ministries, was designed to capture two types of data: (1) information on assets for new project and (2) information on operating and maintenance cost. The main problem with the current system is that it is not able to capture the subsequent capital expenditure as additional value to the existing assets. This is because for any subsequent expenditure, the system will automatically treat it as operating and maintenance cost, which

will be immediately expensed off. The major implication of this issue is that government assets will be undervalued.

Another issue will arise when the assets are disposed of (i.e. derecognised). The value of the disposed assets will not reflect the actual value of the assets as only the value of the assets at the point of initial recognition is being disposed of as the system is not able to capture the capital expenditure related to the asset. This is contradictory to the guideline by IFAC (2011) on adoption of IPSAS whereby "any assets or components of assets which are replaced as part of an upgrade or improvement program need to be removed from the asset register and any other relevant records. Any residual carrying value for such assets or components would need to be written off at that point".

4.2 Measurement At (After) Recognition

4.2.1 Undervaluing of Assets

According to IPSAS 17, upon recognizing an item as a PPE asset, it should be measured at cost. The cost of a PPE item covers its purchase price, any costs directly attributable to bringing the asset to the location and the condition necessary for it to be able to operate, and the initial cost of dismantling and removing the item and restoring the site on which it is located (IPSASB, 2011b, pp: 517). In other words, all incidental costs need to be included in the initial cost price of a PPE asset. The issue arises when the responsible staff, may intentionally or unintentionally omit all or part of the incidental costs of the PPE item when keying in the initial value of the PPE asset into the system. Consequently, it leads to underestimation of the value of the assets. The major reason that leads to this problem of underestimating the value of the assets is due to incompetency of the staff when keying the cost information of the assets into the system, specifically in ensuring that all relevant costs are captured in arriving at the total initial cost of the assets.

4.2.2 Lack of Detailed Guidelines on Fair Value Measurement

Under IPSAS 17, fair value measurement is to be used to value PPE assets when information on the historical cost of an asset is not available. The advantage of using fair value is that it is more accurate as it reflects the current economic value of the assets. However, at present, there is a lack of detailed guidelines to address the subjective issues regarding fair value measurement, such as on the various hierarchy of fair value as adopted in the private sector companies based on IFRS 13 on Fair Value Measurement.

4.2.3 Unavailability of Data/Information on the Asset

There are several related issues in this context. First, documents on asset acquisition for some PPE assets, especially those that were acquired a long time ago have gone missing. As a result, the historical costs of the assets are not retrievable although the assets were purchased at cost. Second, due to various reasons the acquisition date and the useful life

of certain PPE assets are not available. This information is crucial in the calculation of the assets' carrying value, particularly in deriving at the accumulated depreciation value. Third, and, most importantly, a number of agencies have not keyed information concerning their PPE assets into the system, which leads to unavailability of the information.

4.2.4 Undervaluing of Assets Acquired at Nominal Cost

There are government PPE assets that were acquired at nominal cost. For example, a piece of land was acquired at RM1 although its actual value is much higher than the nominal cost paid. Based on the focus group discussion with relevant panels, deriving the opening balance of government assets in 2015, the nominal cost will be used as the historical cost of the asset and will be revalued in the subsequent years to reflect its real value. However, the issue that the Government needs to consider is that the misleading opening value of government assets will appear in the 2015 financial statement when accrual accounting is being implemented by the federal government for the first time.

4.2.5 Lack of Competent Valuers

According to IPSAS 17, for a PPE item that is acquired through a non-exchange transaction, the fair value at the date of acquisition is used to measure the value or cost of the item (IPSASB, 2011b, pp: 516-517). Based on the findings of this study, the proportion of government assets that require fair value to the number of qualified valuers is high. In other words, at present there are insufficient government qualified valuers. In achieving the goal to fully implement the accrual accounting system by 2015, this is an important issue to be resolved immediately by the relevant government authority.

4.2.6 Frequency of Revaluation Exercise

According to para 49 of IPSAS 17, the frequency for revaluation of the PPE assets depends on changes of the fair value of the individual group of assets. If the value of a particular group of assets is rapidly changed, then the assets need to be revalued more frequently. In other words, depending on the nature of the assets, the frequency of revaluation is different from one group of assets to another. The main issue addressed by panels of the focus group discussion is that there is no clear guideline on the frequency to revalue the PPE assets.

4.3 Reporting and Disclosure

4.3.1 Extent of Disclosure

According to IPSAS 17, information concerning the value of PPE assets needs to be reported in the Statement of Financial Position, as a specific line item called PPE under the category of non-current assets. The details of the assets based on category are to be provided in the Notes to Account that accompany the annual report. There is an exception given to the Ministry of Defence to report only a single line item of assets in the Statement of Financial Position. The main justification given for this exception is due to the secrecy of the information and for

security purposes. However, several other ministries have also requested to present their assets as a single line item and not show the details of the assets. The issue here is: will there be inconsistency in the extent of disclosure between ministries? More importantly, if ministries are requesting to report limited information concerning their assets in the financial statements, the ultimate objective of full disclosure under accrual accounting will not be achieved.

4.3.2 Inefficiency of Asset System

The current system is not able to differentiate the various modes of PPE procurement. In particular, the system will not be able to differentiate between PPE assets procured using the traditional mode of procurement and PPP/PFI. As a result, in reporting the assets in the Statement of Financial Statement, the information on the value of PPE assets based on the mode of procurement is not available.

5.0 Recommendations to Resolve the Issues

This section offers potential solutions in overcoming the issues and challenges highlighted in the previous section (i.e. Section 4.0).

5.1 To Develop Relevant Policies, Guidelines or Standards

5.1.1 Definition of An Asset

In addressing the issue of inconsistency in the definition of an asset, the relevant authority, such as the AGM, may want to set a standard definition of assets (i.e. PPE) for public sector entities by taking into account the definition as outlined in the accounting standards (i.e. IPSAS 17).

5.1.2 Recognition of Assets: Capitalization Threshold

The accounting standards (i.e. IPSAS/MPSAS 17 on Property, Plant and Equipment) only provide general requirements on accounting treatment for PPE assets. A detailed guideline may need to be developed to assist the work of officers who are in charge of recording and reporting transactions on PPE assets. In addition, the capitalization threshold of RM10,000, which is currently practised, needs to be relooked at. Due to the arbitrary nature of the threshold, reasonable justifications are to be provided.

5.1.3 Assets Ownership

In relation to the issue of an asset shared by more than one ministry, to avoid double recording or double counting of the asset, a guideline should be introduced to determine the entity responsible to recognize and to record the asset in its financial statement or to determine the amount (value) of the asset to be recorded by each ministry who share the asset. The basic accounting policy of substance over form needs to be used in preparing the guideline policy.

5.1.4 *Fair Value Measurement*

A detailed guideline is necessary to address various issues on fair value measurement of a PPE asset. The guideline should include, among others, the techniques for fair value measurement and conditions of criteria of an asset applicable for each of the fair value techniques. A close reference can be made to the International Financial Reporting Standard (IFRS) 13 on *Fair Value Measurement* in developing the guidelines.

5.1.5 *Revaluation of PPE Assets*

As highlighted in the IFAC 2011, several steps should be undertaken in valuing the assets. These include: (a) develop appropriate valuation policies, including the valuation method, for each class of asset; (b) decide whether assets within those classes are to be valued; (c) prepare instructions for valuers; (d) collate information required by valuers; (e) select valuers; and (f) perform management review of valuations. A guideline on the frequency of revaluation for different groups of asset need to be established to ensure consistency in the revaluation practice among ministries.

5.2 **To Have Efficient Asset Management System**

5.2.1 *To Improve Existing Asset Management Systems*

The existing asset management systems (i.e. MySPATA and 'Sistem Pengurusan Aset Alih' (SPA)) need to be improved, particularly for the system to be able to capture and differentiate between capitalised expenditure and operating and maintenance cost. This is important to ensure the accuracy of asset values that are being recognised and derecognised (disposed of). This is consistent with the statement in IFAC (2011), which states that the reliability of reporting the assets carrying value is mainly based on adequate asset management plans or other appropriate information systems that are used to estimate the decline in future economic benefits and depreciation.

5.2.2 *To Integrate Existing Asset Management Systems*

It is recommended that the existing asset management systems (i.e. MySPATA and SPA) be integrated into one system to record all assets of the government. Having an integrated asset system, to some extent, can ease the management of the government assets, and, therefore, leads to efficiency in managing government assets.

5.3 **Education and Training of staff**

Currently, the Malaysian Government is using cash basis accounting for its transactions. The transition from cash basis accounting to accrual accounting in 2015 will create challenges for government officers as accrual accounting is new to them. Therefore, intensive education and training on accrual accounting is necessary to ensure that officers are competent in delivering their duty once accrual accounting is implemented.

5.4 Other Recommendations

5.4.1 Verification by Third Party: Useful Life of the Asset

Pertaining to the issue of incomplete data to determine the useful life of the asset, it is necessary to engage experts in the specific area to estimate the useful life of the specific types of asset. For instance, to estimate the useful life of medical related assets, those directly involved in supplying or dealing with medical assets need to be consulted. This is due to the importance of information concerning the life of the asset, which determines the accuracy of the carrying value of the assets to be disclosed in the Statement of Financial Position of the government entity.

5.4.2 Identification of PPE Initial Cost and Incidental Cost from the Source of Documents

The initial measurement of an item of PPE is undertaken with the recognition that a PPE item that qualifies for recognition as an asset should initially be measured at its cost. The cost of an item of PPE comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use. Any trade discounts and rebates are deducted in arriving at the purchase price. These are a few examples of directly attributable costs, which are the cost of site preparation, initial delivery and handling costs, installation costs, and professional fees, such as for architects and engineers. In addition, the asset management officer should scrutinize the invoices and receipts of payment as the source of documents in order to identify attributable costs that must be capitalized as part of the cost of PPE as mentioned above.

5.4.3 Extent of Reporting and Disclosure of PPE Items

Due to the issue of different levels of disclosure by different ministries, greater enforcement for the ministries to adopt the accounting standards should be put in place. This is to avoid complaints from users and preparers of accounts concerning the exemption given to certain entities for not disclosing related information without a satisfactory reason.

5.4.4 Notes to the Financial Statements

In the event that a government entity has not fully complied with the accounting standards due to unresolved issues, it is recommended that adequate notes accompanying the financial statements be provided to inform and justify the non-compliance. This is important to avoid the misconception or misperception of the public concerning the government financial statements that are prepared using the accrual basis.

6.0 Conclusion

The present study highlights the issues and challenges in implementing IPSAS 17. The identified issues are presented under three sub-categories – recognition and de recognition, measurement at and after recognition, and reporting and disclosure. In addition,

recommendations are provided to address the identified issues. The findings concerning the issues and recommendations are important to relevant parties, such as the Accountant General's Department, which is the most responsible entity in ensuring the smooth transition to the accrual accounting system. The issues highlighted could allow the Accountant General's Department to take early action to mitigate the potential future problems. For instance, information concerning the lack of staff competency in recognizing PPE assets using the accrual accounting basis is one of the key issues, and allows the relevant parties to strategize intensive training sessions to address the issue before full implementation of accrual accounting in 2015. More importantly, the recommendations offered in this study, to some extent, could assist the Government, particularly the Accountant General's Department, Auditor General's Department and all ministries in resolving the issues for a smooth transition to accrual accounting.

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