

Financial Reporting Reform in Malaysian Local Authorities

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I. Introduction

In Malaysia, the Local Government Act of 1976 has provided local authority broad functions and responsibilities. These include environmental, public amenities, public health and cleansing, social functions and development projects. To perform these functions and responsibilities, Malaysia has 145 local authorities represented by 10 City Councils, 33 Municipal Councils and 102 District Councils.

For the past few years, local authorities in Malaysia are facing issues from many interested parties regarding their financial performance. Financial performance shows the end result of the Statement of Financial Performance (or Income Statement). It will indicate break-even, surplus or deficits fund balance. Fund balance is the difference of current year revenue and expenditure (Rubin, 1996).

ACCA (2007) stated that surplus fund balance may arise due to a failure to provide agreed level of services by the local authorities. ACCA further indicated that deficit fund balance may be a signal of responsiveness to a change in local needs and demand. The continuous deficit in fund can lead to bankruptcy, debt default and the government entities being not able to meet with the increasing expenditure (ACIR, 1985).

The issue of deficit in local authority is serious but it continuously recurring. Many studies had been done to evaluate the financial performance of local authorities. The trend analysis is commonly and extensively used in practice because it is relatively simple to apply (Colbert, 1991). According to a study by Gregory (1994) financial trend analysis indicates that the number of local authorities reporting a deficit fund balance increases and thus, the size of deficits also increases. Other prior studies emphasize the effect of revenue and expenditure in local authority financial trend analysis over years such as by Ibrahim (1994), Gregory (1994), Pradhan and Swaroop (1993), Matton (2004) etc.

The United Nations (1998) stated that the most concern area in local authority finance in Malaysia is on revenue and expenditure. Nafsiah et al (2006) indicated that district councils mainly do not have additional revenue to meet the demands and expectations of their communities compared to city councils. The study further indicated that district councils more tended to have deficits fund balance compared to municipal or city councils. Thus,

this situation warns that the district councils may face continuing financial distress (Gregory, 1994). On the other hand, Pradhan and Swaroop (1993) identify that over development expenditure in local authorities could also lead to financial distress.

Today, local authorities have a greater need for sound and practical financial information. The situations clearly points to the need for better planning and evaluation of the current and future financial needs of the local authorities.

II. Financial Trend Analysis

Not many studies have been done to identify the trend of revenue and expenditure and particularly surplus and deficits status in local authority. A study done by Ibrahim (1994) over seven years among three groups of United Kingdom local authority evaluation in expenditure trend analysis identified that there were differences in expenditure because of the political ideology of the controlling political party. However, in Malaysia this is not relevant since most state governments in Malaysia currently is governed by the ruling party except for state of Kelantan, Kedah, Pulau Pinang and Selangor.

Another study evaluates the trend analysis of revenue and expenditure of local authorities in a financial crisis as well as the ability of the entity to provide services. Gregory (1994) affirmed that part of the local authority method to acquire more revenue is that they tend to raise taxes and fees, reduce expenditure and use "accounting gimmicks" which slows economic growth. Also cited by Gregory is a study done by the United States General Accounting Office (GAO) on local authorities in United States, which covered seven years period of 1985 to 1991. The study revealed that the year-end budget surpluses were down because the spending grows faster than revenue. According to his study, financial trend analysis indicates that the number of local authorities reporting a deficit fund balance increases and the size of deficits also increases in three years. The government reduced their spending through salary cut, stopped necessity new workers, reduced capital expenditures and reduced pension contribution in time of decline in economic growth in 1989.

A study done by Matton (2004), on surplus and deficit performance trend analysis of state government and local authority found that the economic recession in 2002 led to an effect on the revenue and expenditure structure, as well as the funding structure. The study also indicates that differences of the structure of financing and financial crisis should be taken into consideration in order to manage overall financial performance. The study was conducted for a 42 year period starting from 1960 until 2002 in the United States.

The literature on financial trend analysis of local authority indicates that this type of analysis will identify the abnormal pattern that may give signs of danger. The trend analysis is also commonly and extensively used in practice because it is relatively simple to apply (Colbert, 1991). In addition, the pattern will reveal other factors that may influence the financial performance and financial condition of local authority such as the primary factor being highlighted in the literature is economic crisis.

Performance measurement includes non-financial (service) and financial measures. Performance measurement is able to promote accountability to stakeholders. There is the need to measure performance particularly in government entities, as there is an increasing demand for accountability from citizens and media at present. Foltin (2005) mentioned that there is little information on government performance. There is a necessity for performance measurement of government since the issue of economic crisis, decreasing revenue streams, federal funding reduction and to improve government entity's operation. Performance measurement by definition as he stated " the process of determining how effectively and efficiently taxpayers resources are being used for the delivery of services or the administration of programs" which include Activity Based Costing (ABC), The Balanced Scorecard, Benchmarking, Best Practices, Outsourcing/ Privatisation, Performance Budgeting, Process Reengineering, Ratio Analysis and Shared Services.

Many studies in local authorities in the early 20th century have made an effort to improve government performance by addressing issues of efficiency, effectiveness, and economy in services (Ingraham et al, 2003). Efficiency is defined as minimizing inputs for a required output or maximizing output for a given set of inputs. Effectiveness is defined as to accomplish the defined task to the given period (Palmer, 1993). While economy is defined as acquiring resources in sufficient quantity at minimum cost, effectiveness is consistent with concepts of non-financial accountability.

The most essential measurement for performance emphasized in determining accountability is in financial and accounting information (Hyndman and Anderson, 1995). In addition measuring economy and efficiency can be categorized as financial performance (Fitzgerald et al., 1991, and Kaplan and Norton's, 1992) that is measured from financial information. Therefore, the government sector has to be more concerned about their financial performance as this exhibit their accountability and as well as the economy and efficiency measurement.

III. Financial Reporting Requirement

There is no requirement that it is obligatory for the local authorities in Malaysia to adopt specific financial reporting standards. Tayib (1995) identified four accounting standards that are being practiced by local authorities in Malaysia namely; International Accounting Standards (IAS), guidance issued by the Ministry of Housing and Local Government (GMHLG), self created accounting practices (SCAP) and Federal Treasury Circular (FTC). Thus, the optional requirements give alternatives to the local authorities in Malaysia to adopt which they feel suit better to them. Consequently, this led to inconsistency in presentation of the Financial Statements, which are difficult to compare within the same entities.

Accordingly, financial deficit in government measurements as identified by Blejer and Cheasty (1991), is uncertain because there are no standard accounting regulations being practiced. The two main differences identified by them which are firstly, how the revenue and expenditure, and financing characteristic caused the deficit and secondly the period of

sources being measured because there are two basis of preparation of financial statement whether accrual or cash basis or both applied.

However, all the local authorities in Malaysia financial reporting complied with IAS (Asmah and Erolyn, 2006) and guidance provided by Federal Treasury Circular (FTC) where the local authorities being audited primarily by Government Auditor General (Tayib et al, 1999). Different practices in Financial Reporting by local authorities make it difficult in term of comparisons.

If a local authority is not able to pay its liabilities and its expenditure exceeds its revenue, this would result in deficit. Deficit occurred due to revenue in arrears (Mahamad Tayib and Rose Shamsiah, 2002; and Mahamad Tayib, 2004). According to the Auditor General Office, one of the reasons for revenue in arrears in local authorities was due to cheques, money orders and postal orders not presented to the bank on time (Mariam, 2004). All the head of agency are not supervising properly the financial and account transactions.

This directly affect the States performance where in 2002, all States had incurred deficit. Thus, it is important that these issues are studied and recommendations made to assist the local authorities in managing their fund.

IV. Conclusion

Initiatives taken by the Accountant's General Department to award a research grant relating to the financial performance of local authorities to Universiti Teknologi MARA is the perfect timing. It is hope that the objectives of the study are achieved and would benefit the local authorities and other relevant authorities.

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