

A Guideline Framework For Recognition, Measurement And Reporting Of Malaysian Government's Property, Plant And Equipment Under Accrual Accounting

Suhaiza Ismail

Department of Accounting.

International Islamic University Malaysia

Tahirah Abdullah, Siti Afiqah Zainuddin

Universiti Malaysia Kelantan

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Abstract

This paper provides a framework for recognizing, measuring and reporting of Malaysian government's non-current assets that are classified as property, plant and equipment. The framework which is mainly developed based on the International Public Sector Accounting Standard (IPSAS) 17 on Property, Plant and Equipment offers guidelines to interested parties on the appropriate accounting treatment for assets that fulfill the criteria of property, plant and equipment.

Keywords: accrual accounting, IPSAS 17, property, plant and equipment, recognition, measurement, reporting

INTRODUCTION

The shifting of public sector entities' accounting basis from cash to accrual basis has taken place in a number of developed countries including New Zealand, United Kingdom, Canada, United States, Columbia and France (Dickinson, 2000, Saleh and Pendlebury, 2006). Later, the emerging economies such as Philippines and Cambodia have also gradually shifted away from cash accounting towards the accrual based accounting (Andriani, Kober and Ng, 2010). The main difference between the accrual and cash basis lies in the timing as to when the transaction is recognized. A cash based system recognizes transaction at the date of spending, whereas an accrual based system spreads the costs of investments over time (in the form of depreciation of assets) (Sanderson and Schaik, 2008).

In particular, accrual accounting which is a world-widely accepted accounting basis for the private sector is the method of recording financial transactions where the full characteristics

of those transactions are recorded in the period to which they relate. All assets owned by the organization at the end of the period and all liabilities which exist at that point is also recognized in the financial statements. In addition, revenues earned and resources consumed in a period are recorded (Cohen, Kaimenaki and Zorgios, 2007; and Andriani, Kober and Ng, 2010). In contrast, cash accounting records the cash movement effects of the transactions in the period in which they occur (Sanderson and Schaik, 2008; and Andriani, Kober and Ng, 2010).

A major limitation of using cash basis accounting is that it does not produce full information about the cost of policy implementation if certain expenditures yield benefits over a number of years, such as investment expenditure (Lally and Smith, 1997; Barton, 2009). The problem is resolved if accrual accounting is used as it produces better quality and more useful information about financial performance and position of public resources for decision making purposes, which cash accounting fails to provide (Connolly and Hyndman, 2006; Andriani, 2010). In addition, using accrual basis would allow for more accurate comparison of performance between different entities (Mohammadi, Maher, and Zare, 2012). Most importantly, in the context of the public sector, the use of accrual accounting allows greater transparency and enhances good governance and accountability of the public sector to the society at large in utilizing the public resources for implementation of public policies (Kober, Lee and Ng, 2010).

As the government of Malaysia has announced its commitment to adopt accrual basis in the public sector accounting and reporting by the year 2015 (Accrual Accounting Project Team, 2012), one of the important areas affected due to the adoption of accrual accounting is the non-current assets of the government. This is particularly because under cash accounting balance sheet which shows the position of government's non-current assets is not prepared. Hence, this present study intends to provide a framework for recognition, measurement and reporting of federal government's non-current assets particularly the property, plant and equipment based on the International Public Sector Accounting Standard (IPSAS) 17 on Property, Plant and Equipment. The unique contribution of this study is that it provides guidelines for recognizing, measuring and reporting of non-current assets of Malaysian government which is useful to various parties particularly those who involve in preparing the financial statements for the government.

The remaining of this paper is structured as follows. The next section offers description the accounting regulatory framework for government at the international level as well as in Malaysia. This is followed by a section that describes the IPSAS 17 on PPE. Then, a main section of the paper which provides a guideline framework for recognizing, measuring and reporting of PPE based on the relevant international public sector accounting standards particularly the IPSAS 17 on property, plant and equipment (IPSASB, 2011b) and IPSAS 1 (IPSASB, 2011a) on presentation of financial statements is presented. Finally, a section is provided to summarize and conclude the paper.

ACCOUNTING REGULATORY FRAMEWORK FOR PUBLIC SECTOR

At the international level, the International Federation of Accountants (IFAC) is the global organization for the accountancy profession which aims at strengthening the profession and contributing to the development and implementation of high quality international standards (IFAC, 2012). Under the facilitation of IFAC, the International Public Sector Accounting Standard Board (IPSASB) is a standard setting body which produces international accounting standards for public sector entities (IPSASB, 2012). In addition to the responsibility to produce standards, the IPSASB also produces guidance and useful resources in assisting public sector entities worldwide to prepare government's financial statements. The main aims of the IPSASB are to establish high quality accounting standards for public sector entities, to promote the acceptance of the public sector entities worldwide to IPSASs, to furnish useful information for public sector financial management and decision making, and to provide guidance on issues and experiences in financial reporting in the public sector (IPSASB, 2012).

In ensuring high quality standards are developed, in the development process of producing standards, the IPSASB considers feedbacks from various stakeholders including preparers and users of the financial statements. In producing a standard, Exposure Draft is initially developed by a task force or project advisory panel. The ED is made publicly available for feedback and input for improvement and at the same time a Consultation Paper to further explore the subject matter is produced. The standard is finalized only with the affirmative vote of at least two-thirds of the IPSASB members (IPSASB, 2012).

One of the key agendas of the IPSASB is to converge the IPSASs with the International Financial Reporting Standards (IFRSs), which are meant for use by private sector entities. In achieving the objective of its agenda, IPSASB has developed guidelines or rules for modifying IFRSs for application by public sector entities. Since 1997, the IPSASB has published 31 public sector accrual standards and a cash basis standard for countries that are moving towards full accrual accounting.

In the Malaysian context, under the Financial Reporting Act 1997, the Malaysian Accounting Standard Board (MASB) was set up with the main role to develop accounting standard for both private and public sector entities. In addition, the MASB is also aimed at promoting high quality accounting standards to be at par with the international standards (MASB, 2012). The commitment of the Malaysian government to adopt accrual accounting by the year 2015 is one of the government's initiatives under the Economic Transformation Programme of the Malaysian New Economic Model, which was officially introduced in 2010. In materializing the agenda, MASB together with the Malaysian Institute of Accountants were given the responsibility to produce the transition to accrual accounting roadmap. At present, the MASB together with Malaysian Department of Accountants are taking pro-active efforts in preparing

to shift towards accrual accounting particularly in complying to IPSASs and also in developing public sector accounting standards that are tailor-made to the unique socio-economic and environment of the country.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD (IPSAS) 17

IPSAS 17 on Property, Plant and Equipment was produced by the International Public Sector Accounting Standards Board (IPSASB) in December 2001. The first revision of the standard was made five years later in December 2006. Since then, there were several other revisions to IPSAS 17 due to the introduction of new IPSASs including IPSAS 27 on Agriculture and IPSAS 31 on Intangible Assets which were issued in 2009 and 2010 respectively. The latest revised version on IPSAS 17 was published 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. The plant, property and equipment cover by IPSAS 17 are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. In addition, the tangible items are also expected to be used during more than one reporting period (IPSASB, 2011b, pp: 514). According to the standard, specialist military equipment and infrastructure assets are also classified as PPE (IPSASB, 2011b, pp:512). However, biological assets related to agricultural activity and mineral rights and reserves are not covered by the standard (IPSASB, 2011b, pp:512).

A GUIDELINE FRAMEWORK FOR RECOGNITION, MEASUREMENT AND DISCLOSURE OF PPE ASSETS BASED ON IPSAS 17.

The main components of the accounting treatments for PPE assets include recognition and derecognition, measurement and reporting or disclosure of information on the assets. The following sub-sections discuss on the appropriate treatment of each component.

Recognition and derecognition of PPE

In recognizing an asset as PPE, the item has to fulfill two criteria that are: 1) It is probable that future economic benefits associated with the item will flow to the entity; and 2) the cost or fair value of the item can be measured reliably (IPSASB, 2011b, pp: 514). In addition, the costs of a PPE asset include both costs incurred initially to acquire or construct and costs incurred subsequently to add to, to replace part of or to undergo major service (IPSASB, 2011b, pp: 516).

A PPE item is derecognized either when the item is disposed off or when the asset provides no future economic benefits from its use. When an item of PPE is disposed off, the difference between the net disposal proceeds and its carrying value is the gain or loss on disposal which shall be recorded as surplus or deficit (IPSASB, 2011b, pp: 527-528).

Measurement of PPE

Measurement of PPE items are made at two points; i.e., at the time of recognition and after recognition. At the point of recognition of an asset as a PPE item, the asset should be measured at cost which is the cash price equivalent of the asset. The cost of a PPE item covers its purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for it to be able to operate and the initial costs of dismantling and removing the item and restoring the site on which it is located (IPSASB, 2011b, pp: 517). However, for a PPE item which 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).

For subsequent measurement of the PPE item (i.e. measurement after recognition), an entity can choose either to adopt the cost model or the revaluation model but the chosen model needs to be adopted to the entire assets that is in the same class of assets (IPSASB, 2011b, pp: 520). Using the cost model, the value of a PPE item is measured at its cost, less accumulated depreciation and accumulated impairment losses. On the other hand, using the revaluation model, an item of PPE whose fair value can be measured reliably shall be carried at a revalued amount less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The revaluation needs to be carried out when the fair value of the asset differs significantly from its carrying value and the recommended frequency of revaluation is every three or five years (IPSASB, 2011b, pp: 521).

Treatment for PPE revaluation

If the carrying amount of a class of assets is increased as a result of a revaluation, the increase shall be **credited directly to revaluation surplus**. However, the increase shall be recognized as surplus or deficit to the extent that it reverses a revaluation decrease of the same class of assets previously recognized in surplus or deficit. In contrast, if the carrying amount of a class of assets is decreased as a result of a revaluation, the **amount of decrease shall be recognized as surplus or deficit**. However, the decrease shall be debited directly to revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that class of assets.

Depreciation of PPE

The depreciation of a PPE item should be allocated on a systematic basis over its useful life. Although the straight-line method, the diminishing balance method and the unit of production

method are common depreciation methods for PPE items, the appropriate method to be used is the one that reflects the patterns of the future economic benefits of the asset consumed by an entity (IPSASB, 2011b, pp: 526). The depreciation charge for each period shall be recorded in as surplus or deficit.

Based on description on IPSAS 17 in the earlier section, a framework for recognizing and measuring the government's property, plant and equipment is proposed as shown in Diagram 1. The framework offers step by step procedures in applying the standard on PPE particularly on the recognition and measurement of PPE assets. Table 1 provides interpretation to the framework in terms of qualifying criteria and necessary treatment on recognition and measurement. As shown in diagram 1, the first step is to recognize whether the asset is a PPE item. If the asset is recognized as a PPE item, it shall be treated according to the IPSAS 17, hence the focus of this framework. Upon recognition, an appropriate measurement for the asset is determined based on how the asset was initially acquired. Generally, the measurement is based either on cost or fair value as depicted in Diagram 1. For subsequent measurement, if the asset is initially measured at cost, the carrying value of the asset is the value after deducting the accumulated depreciation. On the other hand, if the asset is valued at fair value, from time to time the asset needs to be revalued and the carrying amount is based on the revalued value minus the accumulated depreciation.

Diagram 1: Framework for Recognition and Measurement of PPE Assets

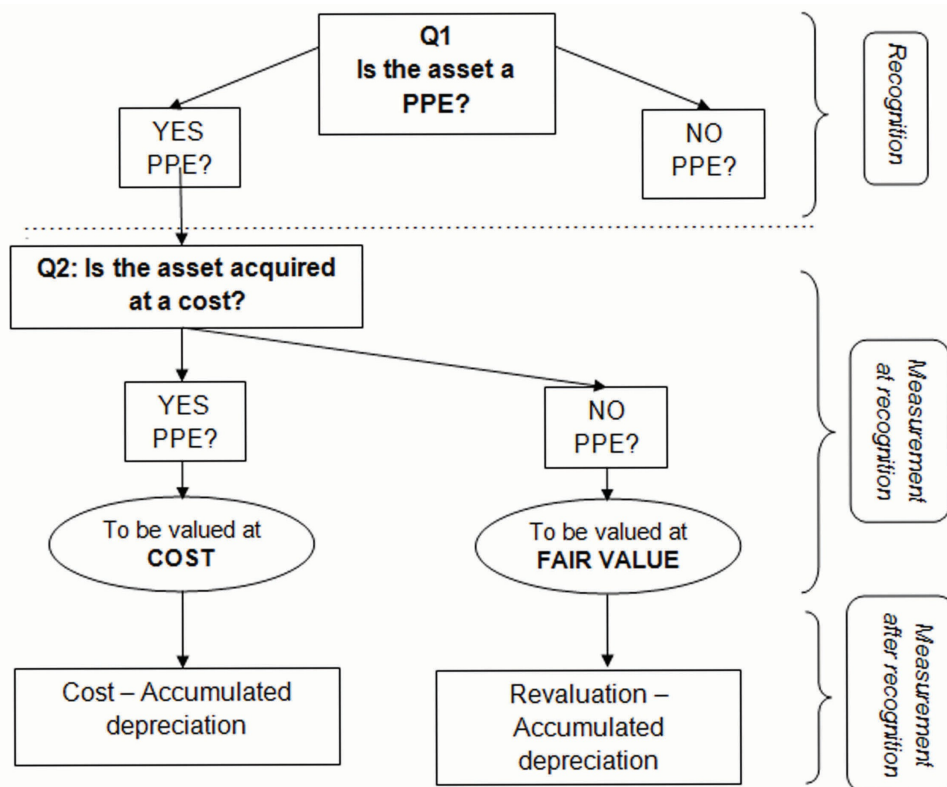


Table 1: Interpretation to Diagram 1 on the Framework for Recognition and Measurement of PPE Assets

	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

Reporting and Disclosure of PPE

In general, the information on PPE is recorded in three main financial statements that are Statement of Financial Position or balance sheet, Statement of Financial Performance or known as 'Surplus and Deficit' and Statement of Changes in Net Assets (IPSASB, 2011a). In particular, in the Statement of Financial Position, information on PPE value is required to be shown in a specific line item called property, plant and equipment under the category of non-current assets as shown in **Illustration 1 below** (to insert the illustration) (IPSASB, 2011a, pp: 78).

Illustration 1: Statement of Financial Position**Public Sector – Statement of
Financial Position****As at December 31, 20X2**

(in thousands of currency units)

ASSETS	20X2	20X1
Current assets	X	X
Cash and cash equivalents	X	X
Receivables	X	X
Inventories	X	X
Prepayments	<u>X</u>	<u>X</u>
Other current assets	<u>X</u>	<u>X</u>
Non-current assets		
Receivables	X	X
Investments in associates	X	X
Other financial assets	X	X
Infrastructure, plant and equipment	X	X
Land and buildings	X	X
Intangible assets	X	X
Other non-financial assets	X	X
	<u>X</u>	<u>X</u>
Total assets	<u>X</u>	<u>X</u>
LIABILITIES		
Current liabilities		
Payables	X	X
Short-term borrowings	X	X
Current portion of long-term borrowings	X	X
Short-term provisions	X	X
Employee benefits	X	X
Superannuation	X	X
	<u>X</u>	<u>X</u>

Non-current liabilities

Payables	X	X
Long-term borrowings	X	X
Long-term provisions	X	X
Employee benefits	X	X
Superannuation	X	X
	<u>X</u>	<u>X</u>
Total liabilities	<u>X</u>	<u>X</u>
Net assets	<u>X</u>	<u>X</u>

NET ASSETS/EQUITY

Capital contributed by		
Other government entities	X	X
Reserves	X	X
Accumulated surpluses/(deficits)	X	X
Minority interest	X	X
	<u>X</u>	<u>X</u>
Total net assets/equity	<u>X</u>	<u>X</u>

In the Statement of Financial Performance, the information relevant to PPE to be disclosed includes depreciation of PPE and impairment of PPE which are shown under different line items as depicted in **Illustration 2** (IPSASB, 2011a, pp: 80). Information to be reported in the Statement of Changes in Net Assets/Equity comprises of gain and loss on PPE revaluation. In addition, if the PPE item is derecognized (i.e. disposed off) during a particular financial period, information on gain or loss on disposal of the PPE items needs disclosure in surplus or deficit during the year (IPSASB, 2011, pp: 527).

Illustration 2: Statement of Financial Performance**Public Sector Entity—Statement of Financial Performance for the Year Ended December 31, 20X2**

(Illustrating the Classification of Expenses by Nature)
(in thousands of currency units)

	20X2	20X1
Revenue		
Taxes	X	X
Fees, fines, penalties, and licenses	X	X
Revenue from exchange transactions	X	X
Transfers from other government entities	X	X
Other revenue	X	X
Total Revenue	<u>X</u>	<u>X</u>
Expenses		
Wages, salaries, and employee benefits	(X)	(X)
Grants and other transfer payments	(X)	(X)
Supplies and consumables used	(X)	(X)
Depreciation and amortization expense	(X)	(X)
Impairment of property, plant, and equipment	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
Total Expenses	<u>(X)</u>	<u>(X)</u>
Share of surplus of associates	X	X
Surplus/(deficit) for the period	X	X
Attributable to:		
Owners of the controlling entity	X	X
Minority interest	X	X
	<u>X</u>	<u>X</u>

Illustration 3 shows the format for presenting the Statement of Changes in Net Assets/ Equity and highlights information on PPE in the statement (IPSASB, 2011a, pp: 81-82).

Illustration 3: Statement of Changes in Net Assets/ Equity

Public Sector Entity—Statement of Changes in Net Assets/Equity for the Year Ended December 31, 20X1

(in thousands of currency units)	Attributable to owners of the controlling entity					Minority interest	Total net assets/ equity
	Contributed Capital	Other Reserves	Translation Reserve	Accumulated Surpluses/ (Deficits)	Total		
Balance at December 31, 20X0	X	X	(X)	X	X	X	X
Changes in accounting policy				(X)	(X)	(X)	(X)
Restated balance	X	X	(X)	X	X	X	X
Changes in net assets/ equity for 20X2							
Gain on property revaluation		X			X	X	X
Loss on revaluation of investments		(X)			(X)	(X)	(X)

Exchange differences on translating foreign operations		(X)		(X)	(X)	(X)
Net revenue recognized directly in net assets/equity	X	(X)		X	X	X
Surplus for the period				X	X	X
Total recognized revenue and expense for the period	X	(X)		X	X	X

(in thousands of currency units)	Attributable to owners of the controlling entity					Minority interest	Total net assets/equity
	Contributed Capital	Other Reserves ⁴	Translation Reserve	Accumulated Surpluses/ (Deficits)	Total		
Balance at December 31, 20X1 carried forward	X	X	(X)	X	X	X	X
Balance at December 31, 20X1 brought forward	X	X	(X)	X	X	X	X

Changes in net assets/ equity for 20X2						
Loss on property revaluation	(X)		(X)	(X)	(X)	(X)
Gain on revaluation of investments	X		X	X	X	X
Exchange differences on translating foreign operations		(X)	(X)	(X)	(X)	(X)
Net revenue recognized directly in net assets/equity	(X)	(X)		(X)	(X)	(X)
Deficit for the period			(X)	(X)	(X)	(X)
Total recognized revenue and expense for the period	(X)	(X)	(X)	(X)	(X)	(X)
Balance at December 31, 20X2	X	X	(X)	X	X	X

In addition to the quantitative information on PPE reported in the relevant financial statements of the government, other important information in relation to each class of PPE assets should also be disclosed for the benefits of the users of the government's annual report. The disclosure information include the followings: 1) the measurement bases used in determining the gross carrying value; 2) the depreciation method used and depreciation amount; 3) the useful life of the assets or the depreciation rates used; 4) the gross carrying amount and the accumulated depreciation at the beginning and end of the period; 5) increases or decreases resulting from

revaluations; 6) impairment losses recognized and reversed; and 7) a reconciliation of the carrying amount at the beginning and end of the period showing additions, disposals and acquisitions through entity combinations. **Illustration 3** also depicts the format for presenting the reconciliation information. In the instances of revaluation of a class of PPE, information for disclosure includes the effective date of the revaluation, method used in valuing the PPE and the sum of all revaluation surpluses and deficits.

SUMMARY AND CONCLUSION

The present paper provides a guideline for complying with the international public sector accounting standard specifically the IPSAS 17 on property, plant and equipment in terms of recognizing, measuring and reporting the PPE assets under accrual accounting. In summary, accounting treatments for PPE assets involve recognizing and derecognizing the assets, measurements of the PPE at recognition and after recognition as well as reporting the PPE assets in the relevant financial statements. The public sector financial statements to record PPE assets and other relevant information on PPE include the Statement of Financial Position, the Statement of Financial Performance and the Statement of Changes in Net Assets/ Equity.

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