

“Certification of Central Government Financial Statement” by ASOSAI Chair (JAN)

COUNTRY PAPER:

- i) How can SAIs’ audit approach add value to the accurate and reliable reporting of central government sector assets and liabilities?**
- ii) Planning, execution and reporting for the audit of government financial statements with reference to ISSAIs pertaining to financial statements audit. Looking at the lesson of years of certification practice, which of the applicable ISSAIs may need to be adapted to the certification activity by SAIs? Does ISSAI 1600 provide necessary guidance for the consolidation of state accounts?**

1. INTRODUCTION

1.1 Based on a survey done, majority ASOSAI member countries apply ISSAI in conducting the audit of Central Government account for the last 3 years. Application of ISSAI is further verified through the iCAT on all major types of audit that are financial, performance and compliance audit. Most ASOSAI members apply ISSAI for all of the stages of audit that are Pre-engagement, Planning, Executing and Reporting. Central accounts for most of the ASOSAI members are prepared based on a mixture of both accrual and cash basis accounting. Some ASOSAI member countries such as Australia, Tajikistan, Kuwait and Thailand have begun using accrual basis accounting for their Central Government accounts. This paper will focus on Malaysia’s effort in transforming the usage of modified cash accounting system to an accrual basis accounting by the year 2018 with some ISSAI related challenges and moving forward.

2. JAN’S ACCOUNTING SYSTEM

2.1 Malaysia government’s fund or Federal Consolidated Fund comprised of three accounts namely the Consolidated Revenue Account, the Consolidated Loan Account and the Consolidated Trust Account. The fund is accounted for based on the modified cash basis of accounting in accordance to the requirements of Section 16(1) of the Financial Procedure Act, 1957 [Act 611], Government Accounting Standards and International Public Sector Accounting Standards (IPSAS). On the other hand, by applying the modified cash basis

accounting, government has encountered some issues primarily because the consolidated accounts neither reflect revenues earned nor expenses incurred during the period. The consolidated accounts do not list receivable, prepayment or payables. The current practice is that the expenditures are expensed off during the financial year when payments are made, without consideration to the timing and manner in which the future economic benefits embodied in the expenditure and would flow back to the government. Moreover the financial position of the Federal Consolidated Fund at the end of each financial year, as reported in its financial statements, is too narrow to faithfully represent the resources controlled by, as well as the present obligations of the government. Therefore, the financial information reflected on the financial statements is not complete and does not give a true reflection of the government's financial affairs. Expenditures were reported as they were spent and paid for, not as they were incurred. Revenue was recorded as it was received and not earned. Whereas, the assets are capitalised and recorded outside the accounting system and liabilities are recorded as memorandum without reflecting in the accounts. Accounting system is distributed and disparate because it provides limited information on borrowing credibility, fiscal strategy and accountability for resources.

2.2 In Malaysia, Federal Consolidated Trust Fund has been prepared based on consolidation of revenue and expenses consist of 24 ministries and 13 states transaction and it just represents total figure without consider percentage of ownership as per equity method under IFRS 3: Business Combination because its 100% control by federal government. Furthermore government linked company which government has significant influence has not accounted under federal consolidated fund. Indirectly it does not show the true picture of assets and liabilities owned and obliged in presentation of financial statement. Therefore in context of performing financial statement under International Standards of Supreme Audit Institution, ISSAI 1600: Special Considerations – Audits of Group Financial Statements (including the Work of Component Auditors) is not yet applicable under Malaysia chapter.

3. TRANSFORMATION TO ACCRUAL ACCOUNTING

3.1. In May 2011, the Federal Government of Malaysia launched a major project to transform its current modified cash basis to accrual basis accounting system and to upgrade to the integrated Government Financial and Management Accounting System (1GFMAS). Assets and liabilities will be accounted for and reflected in the accounts. Accounting system will be centralised with single database and fully integrated with Outcome Based Budgeting

(OBB) and other relevant systems. This reform is expected to improve fiscal transparency and accountability for the Federal Government as part of the Malaysia New Economy Model. The key result area of accrual accounting is to provide information on consumption of resources that supports sustainability of fiscal policies and promote transparency of public sector resource management.

3.2. In order to transform to the accrual accounting, the government is in the process to adopt Malaysia Public Sector Accounting Standards (MPSAS) which are based on the equivalent International Public Sector Accounting Standards (IPSAS). To date, 18 MPSASs had been endorsed and issued by the Accrual Accounting Steering Committee. Policies and interpretations regarding accrual accounting have also been developed. The accrual based Federal Government Financial Statement will be prepared in accordance with MPSAS 1 (Presentation of Financial Statement) with financial year ended 31 December. It reflects all cash and accrual transactions and other events for revenue, expenditures, assets and liabilities. The financial statement consists of six components as follows:

- (i) Statement of Financial Position
- (ii) Statement of Financial Performance
- (iii) Cash Flow Statement
- (iv) Statement of Changes in Net Assets/Equity
- (v) Statement of Budget/Expenditure Performance
- (vi) Accounting Policies and Notes to the Financial Statements

Officially, there is only one financial statement prepared for the Federal Government which is based on the combination of 24 ministries' financial statements.

4. BENEFITS DERIVED FROM ACCRUAL ACCOUNTING SYSTEM

4.1. One of the key objectives of transforming cash reporting to accruals is for the government to be more transparent and accountable especially on information relating to assets and liabilities. As a result, decision makers would be able to make informed decisions that are instrumental for our economic growth. For example, accrual accounting will see the correct attribution of the pension costs of government employees to the time period when they are employed and accumulating their pension rights, rather than reporting this as an unrelated expenditure once they have retired under the cash system. The cash system also allows outstanding government debts to be designed in such a way that all interest

expenditure is paid in a lump sum at the end of the loan rather than being spread through the years when the loan was outstanding, as would be done under accruals. These examples indicate how a focus on cash only can distort the true cost of government expenditure. In accrual accounting, economic events are recognised when they occur regardless of when cash transactions occur, meaning economic events are recognised at the time in which the transaction occurs rather than when payment is made (or received).

4.2. The move towards accrual accounting may also see Malaysia gaining better overall credit ratings from critical agencies such as the International Monetary Fund (IMF), World Bank and international business communities as a whole. Financial markets and credit rating agencies are particularly interested in the sustainability of financing and expenditure policies. The IMF contends that accrual financial statements provide greater information for analysing the sustainability of fiscal policy and the quality of fiscal decision-making. In terms of reliability and fair presentation, accrual accounting enables users to see the complete financial position and performance of an entity, whereas cash accounting only enables them to see the payments it makes and receipts it gains. The amount and quality of information available to users of financial statements will therefore significantly increase.

5. ISSUES AND CHALLENGES FOR TRANSFORMATION

Implementation of accrual accounting in the public sector will be challenging like any other reform. Generally public entities face four major obstacles in adopting accrual accounting for the first time. The issues are as follows;

(i) Strategic management issues

These include establishing project teams early, focusing on education and communications, preparing business impact analyses and establishing the right legal and regulatory framework.

(ii) Policy settings

Changing the way in which revenues, expenses, assets and liabilities are recorded and reported will not by itself bring about the desired improvements in public administration. A much broader set of goals and incentives are required to achieve these ideals. Changes to the way in which public services are managed and administered will be necessary to bring about improvements.

(iii) Resource requirements

The demand for specialised skills will substantially increase as the result of the transition. Particular skills in demand will be accounting, IT systems and valuation skills.

(iv) Communications

The need for effective and timely communications is never greater than during a period of change. Communications plans and protocols will need to be developed within agencies with staff and contracted consultants; between agencies and central agencies such as the Accountant General's Department; with government and Parliament, the media and the community.

Although accruals have been used in the private sector for a very long time, it is not possible to simply adopt private sector accruals in the public sector in total. There are a number of unique issues that arise when governments move to accruals. The government has certain types of assets and liabilities that do not exist in the private sector, including heritage assets, military assets, infrastructure assets and the treatment of social security programmes. The type of valuation methods used is also very important, especially from an economic analysis point of view.

6. AUDITORS' ROLE IN THE CERTIFICATION OF CENTRAL GOVERNMENT FINANCIAL STATEMENT

6.1. Articles 106 and 107 of the Federal Constitution and the Audit Act 1957 require the Auditor General to audit the Central Government's Financial Statement, financial management, activities of the Ministries/Departments as well as management of the Government Companies and submit his reports to His Majesty and obtain his assent before tabling in Parliament. To fulfil these responsibilities, Malaysia National Audit Department (NAD) needs to carry out attestation audit to give an opinion as to whether the Central Government's Financial Statement for the year concerned shows a true and fair view as well as its accounting records are maintained properly and kept up to date.

6.2. Audit procedures to be performed are to confirm whether the financial statements submitted are supported by documents consist of certification of balance, individual balance and statement of reconciliation. Besides that, interim audits performed throughout the year to ensure the internal control of accounting systems are appropriate, sufficient and all transaction such as expenses and revenue collection or procurement process comply with stipulated rules and regulation. The financial audit procedures are as follows:

(i) Interim Audit

The audit conducted during the year to verify the accuracy of the financial statements of the Central Government. There are 2 aspects of the interim audit that consist of:

a. Auditing System

The auditing conducted is to determine whether the level of internal control accounting system that existed in the auditees' offices are adequate and satisfactory. The systems that need to be studied are of payments and receipts systems, journals adjustment and payroll system at the level of the accounting office.

b. Auditing Transactions

The auditing is by reviewing of accounting records and documents that are processed through a computerized accounting system and/or by reviewing it manually. The objective is to verify whether the records and documents that have been provided with a perfect, precise, updated and in line with the financial regulations and laws.

(b) Final Audit

The audit carried out after the Central Government's Financial Statements received from the Accountant General of Malaysia. At this stage, the review, verification and analysis of the final balance for the items in the Statement of Financial Position, Statements of Cash Receipt and Payments, Statement of Financial Performance, Statements of Memorandum Account and Notes to the Financial Statements will be made to give an opinion on the Financial Statements of the Central Government whether it gives a true and fair financial position of the Central Government for a financial year. Central Government of Malaysia has successfully obtained the clean audit certificate for Financial Statements that were prepared since 1997.

7. ISSUES AND CHALLENGES

7.1. Malaysia National Audit Department (NAD) is fully supportive of the Federal Government decision to migrate from modified cash accounting to accrual based accounting. The NAD has representatives sitting in 3 accrual accounting committees (Government Accounting Standards Advisory Committee, System Development Working Committee and Accrual Accounting Implementation Committee for OBB) set up by the Accountant General's Office. They give views and opinions on matters relating to accounting standards and policies; law and regulations; process and technology; data collection as well as training. Nevertheless, NAD also faces challenges to ensure the success of the transformation as follows:

(i) Adoption of Accounting Standards MPSAS

As informed by the Accountant General's Office, the Federal Government Financial Statement is prepared based on accrual accounting, the adoption of MPSAS will only be in 2018. However, early adoption is encouraged. If it is only a partial compliance of MPSAS, this may not reflect a fair and true view of the financial position and performance of the Federal Government.

(ii) Asset Management

During the course of current audit, it is observed that there are certain weaknesses especially in assets management. Among others, such as records for movable assets in the computerised are incomplete, not updated and inaccurate. The assets are not properly labelled; kept; ascertained; disposed and verified. Such weaknesses could influence audit opinion when accounts are prepared based on accrual accounting as valuation, existence, ownership and disclosure of these assets may be doubtful and uncertain. As for immovable assets such as land and buildings, drainage, roads, parks and so on, the completeness and accuracy of data collection has yet to be ascertained by all ministries and departments. The capitalisation and depreciation policies for such immovable assets have yet to be implemented accordingly.

The accuracy and completeness of the data kept in system will definitely affect audit opinion under the accrual accounting in terms of valuation, existence and ownership as well as depreciation of such assets. This certainly will affect the accuracy of asset reporting in the Federal Government Financial Statement. Assets could be overstated or understated or even omitted from the record.

NAD expects with the implementation of accrual accounting by the Federal Government, all ministries and departments (including all responsibilities centres) will ensure that the data kept in system are complete, accurate and updated. These are very important to make sure that the opening balances are auditable and can be accepted by the NAD. Currently, the internal auditors at the ministerial level are auditing and verifying the asset records to confirm the opening balance of assets to be reflected in the financial statement.

Under the cash accounting, investments are recorded at cost and reflected in the memorandum account only. There is no provision for diminishing value for investment and no disclosure for market value on quoted shares. There is also no separate financial statement being prepared and audited for investment in Ministry of Finance (Incorporation) (MKD) Companies, simply because there is no such requirement in the MKD regulations. Currently, the Federal Treasury only prepares the investment portfolio report for such investment in MKD companies. This report is not disclosed in the Federal Government Financial Statement. In order to show a true and fair view of the financial position of the Federal Government, the consolidation of the financial position of all MKD companies is necessary once accrual accounting is implemented by the Federal Government.

Complete and accurate data collection and records keeping are vital for accounts receivable to be reflected correctly in the financial statement once accrual accounting is implemented. At the moment, it is only disclosed as notes to account. Audit findings revealed that account receivables are always either overstated or understated or even omitted by various ministries and departments over the years.

Audit findings also revealed that in many instances payment for accounts payable is only done in the following year depending on the availability of current year's budget allocation. Examples of such payment are subsidies and compensation claim. Accuracy and completeness of such data and record keeping for all accounts payable are critical for the preparation of financial statement under the accrual accounting.

7.2. It is hoped that the preparation of accrual based Federal Government Financial Statement for the year ended 2018 is accurate and correct, reflecting a fair and true view of the financial position of the Federal Government. All financial records are properly kept and can support the figures in the financial statement. All such financial records are available for submission or as reference to auditors at the requested time for auditing purpose in order to certify the financial statement within our client's chapter and to produce our timely and quality audit report.

8.0 CONCLUSION

At present, the usage of ISSAI under financial statement audit only applicable for Federal Statutory Body in Malaysia. For Central Government Financial Statement, ISSAI will be applicable when changes to accrual basis have taken place. Therefore, moving forwards to audit the accrual based financial statements, NAD is committed to:

- Draw up a comprehensive capacity building;
- Enhance the competency and knowledge of the auditors by conducting more and systematic programmes and courses;
- Review and enhance present structure in parallel with the government decision to upgrade all existing non self-accounting departments to self-accounting departments;
- Work more closely with the Accountant General's Office and more engagement with the ministries and departments in preparation towards accrual accounting; and
- Review existing Auditing Guidelines for Financial Statement in line with International Standards of Supreme Audit Institutions (ISSAIs) with consideration on the requirements of financial statement prepared based on accrual accounting.

REFERENCES

1. Jurnal Pengauditan Sektor Awam Keluaran Pertama 2014
(Pelaksanaan ISSAI *Compliance Assessment Tools* (iCATs) Pengauditan Kewangan)
2. Jurnal Pengauditan Sektor Awam Keluaran Kedua 2013
(2015 *Accrual Accounting Implementation: Are You Ready?*)
3. Accountants Today August 2011
(Accrual Accounting – The Way Forward)
4. Accountants Today June 2011
(In The Service of The Government)
5. Fokus Akruan Isu No.7 oleh Jabatan Akauntan Negara Malaysia
6. www2.anm.gov.my/akruan