

Accrual Accounting in Malaysia: What We Should Learn from Others

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Abstract

Like any other reform, implementation of accrual accounting in the public sector will be challenging. To prepare for eventual adoption of accrual accounting, there must be change in management where the structured approach for organization change is supposed to take place. The shift towards accrual accounting demonstrates some difficulties and challenges. This paper examines the issues and challenges faced by the New Zealand, Australia and United Kingdom in implementing accrual accounting in the public sector. In doing so, a revision of previous literatures in regard of implementation of accrual accounting in the respective countries were conducted in advocate the research issues. The findings showed that the shift towards accrual accounting demonstrates some difficulties in implementation such as recognition and valuation of assets and liabilities, human competency and, high implementation costs. These implementation barriers are one of many reasons why developing countries should be careful in considering accrual accounting reforms. Being the pioneer countries in the implementation of accrual accounting in public sector, the experiences of New Zealand, Australia and United Kingdom may assist countries especially Malaysia in moving towards accrual accounting reform.

Keywords: public sector accounting, accrual accounting, Malaysia

1 Introduction

Migration from cash accounting to accrual accounting has been stipulated as one of the policy measures in the New Economic Model (NEM)¹ 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], 2013a). 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).

¹ New Economic Model (NEM) outlined the strategies to transform Malaysia to become a high-income country. The goal of NEM is for Malaysia to be a developed country, whose people enjoy high quality of life with high level of income resulting from growth that is both inclusive and sustainable by 2020 (National Economic Advisory Council, 2010). To achieve the goals of NEM, there are 8 Strategic Reform Initiatives (SRIs) outlined in the Economic Transformation Programme (ETP) which include strengthening public sector (Raja Abdullah, 2010).

All federal ministries and departments will be moving to accrual in 2015 and will be closely followed by the state governments in 2016 (International Public Sector Accounting Standards Board [IPSASB], 2013). IPSASB has identified four main areas to be focused on for the success of implementation of accrual accounting namely policies and standards, laws and regulations, process and technology and human resources. The scope of services is include data collection for assets and liabilities, preparation of accrual accounting manual, proposed and implement change management plan, and implementation of data collection training and accrual accounting manual training (Accountant General's Department, 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. Thus, this study conducted in identifying what are the issues and challenges faced by the policy executer in implementing accrual accounting among the pioneer countries and what are the impacts of accounting reforms to them. The previous literature showed that the main issue that disrupted the flow of transition is how the implementers (the pioneer countries) ensure 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. To combat these issues, the implementers have prepared various strategies. Such as, training program, systems synchronization, standards harmonization, and engagement with other stakeholders are among the strategies taken by the implementer in corresponding with the issues raised.

This paper starts with a short revision of previous literature about the implementation of accrual accounting and the issues surround the development and implementation of accrual accounting in several the New Zealand, Australia and United Kingdom. Then followed with a discussion and ended with conclusion.

2 Research Methodology

This research is a revision of previous studies in regard of the implementation of accrual accounting in three countries namely, New Zealand, Australia and United Kingdom. A collection of literatures were reviewed and analyzed, as a result, several keys issues regarding the research subjects were identified and summarized. The keys

issues will be divided into two parts. First part will be concentrated in discussing the issues and challenges faced in implementing accrual accounting in the respective countries. Second part will be elaborating about the impacts experienced by those countries while implementing the accounting reform.

3 Literature Review

Over the last two decades, we have seen greater demands for accountability in public sector where there are significant increasing number of governments around the world employing accrual accounting for financial reporting and budgeting purposes (Chan, 2003; Champoux, 2006). Accrual accounting is said to be beneficial for the governments as it can provide more information for decision makers, leads to a better decision making (Conolly and Hyndman, 2010) and enhances efficiency, effectiveness, transparency and accountability (Guthrie, 1998; Chan, 2003; Ron and Mellet, 2003; Barton, 2005; Nistor et al., 2009; Monteiro and Gomes, 2013). Traditionally, cash accounting is being used by many governments throughout the world (Van Der Hoek, 2005).

Some of the deficiencies in using cash accounting are failure to accurately represent the amount of resource usage and failure to recognize future commitments, guarantees and other contingent liabilities (Ball et al., 2004). Cash accounting does not provide information on how the resources controlled by an entity, the cost of providing goods and services and other financial information for assessing financial position of an entity (Arnaboldi and Lapsley, 2009; Lapsley et al., 2009). Accrual accounting on the other hand provides this kind of information which helps to provide a better overview of the government's financial activities and financial position (Rowles, 2004; Sevic, 2006; Nesbakk, 2011).

The call for action to strengthen public sector accounting became the attention of many governments throughout the world where New Zealand and Australia are frequently cited to have the most comprehensive accrual accounting adoption than any other countries (Tiron Tudor and Mutiu, 2006; Nistor et al., 2009). Other countries such as Sweden, Spain, France, Netherlands, Brazil, Romania, Indonesia, Malaysia and many more countries followed suit thereafter. The shift to accrual accounting in Malaysia is made by Prime Minister YAB Datuk Seri Mohd Najib Tun Abdul Razak as the Federal Government of Malaysia is set to adopt full accrual-based accounting for financial reporting by 1 January 2015 (Gomes, 2013). This is one of the initiatives for Malaysia to be a developed country, whose people enjoy high quality of life with high level of income resulting from growth that is both inclusive and sustainable by 2020 (National Economic Advisory Council, 2010).

According to Gomes (2013), issues and challenges are inevitable wherever change is instituted. Despite the fact that many countries have moved to accrual accounting, objections and arguments continued to be raised by critics. 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 implementation of accrual accounting in New Zealand, Australia and United Kingdom. The discussion continued with the issues and challenges in adopting accrual accounting as experienced by those countries that had moved to accrual accounting are discussed and followed by the impacts of accrual accounting adoption in pioneer countries namely New Zealand, Australia and United Kingdom.

The Implementation of Accrual Accounting- A Background

1 New Zealand

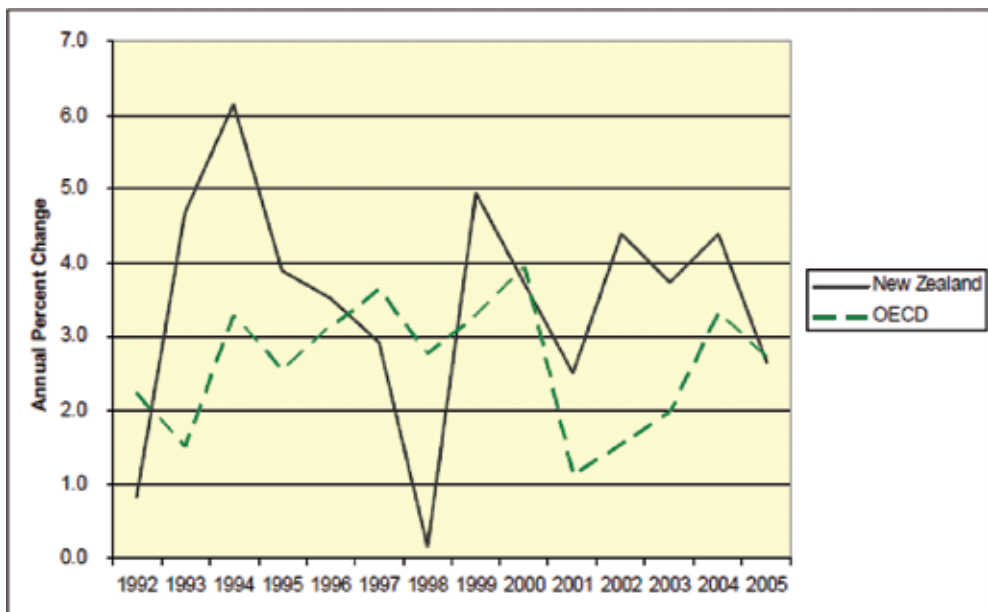
The implementation of accrual accounting in New Zealand took place along with economic reforms. Those changes began in the mid-1980s with the introduction of privatization and corporatization of government-owned commercial entities as well as an abolishment of New Zealand's currency and financial markets (Pallot & Ball, 1996). After that, the government wanted to enhance performance and accountability in its remaining public commercial entities by adopting modern management practices, such as giving tougher personnel authority to chief executives (entity heads) and also wielding performance-based executive assessments (C. Mark, 2006).

Up to 1989, New Zealand's budgeting practice was based on a cash accounting system (C. Mark, 2006). With the approval of Public Finance Act of 1989, New Zealand amended the government's budgeting process into output-based systems, and also demanded that the entire budgeting and reporting were done using accrual methods (C. Mark, 2006). As a result, the Parliament is aware with the full costs of the outputs and measure up to costs with private suppliers (Pallot & Ball, 1996). In addition, to ensuring department reporting and budgeting based on accrual measures, the Public Finance Act required accrual-based performance assessments (New Zealand Treasury, 2005). Later in 1992, New Zealand tabled its initial fully accrual-based comprehensive financial statements, known as the Crown financial statements (Pallot & Ball, 1996).

The accrual-based reforms in New Zealand are debatably the most comprehensive that any country has undertaken to date (GOA Report, 2000). The GAO reports that, in general, most observers seem to agree that the accrual measures have provided better information for purposes of asset management and cost calculations (GOA Report, 2000). Since embarking the transitions, New Zealand has established strong

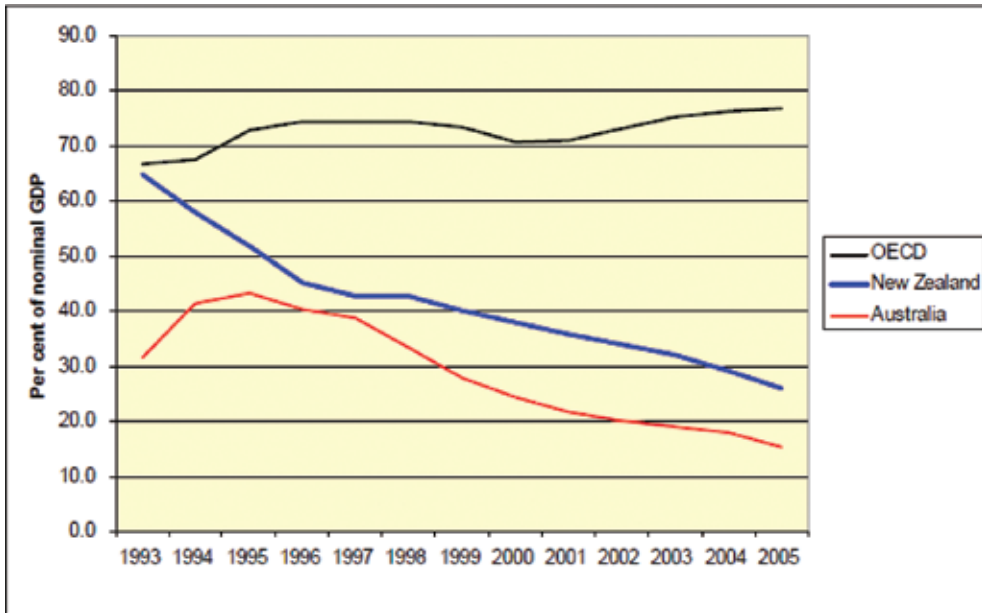
fiscal control. In terms of budgeting, New Zealand increases to core budgets of each department at only a steady immaterial level (C. Mark, 2006)

Surprisingly, New Zealand's gross financial liabilities have reduced from 65% of GDP in 1993 to 23% in 2005, although the OECD as a total has risen from 66% to 76% in the same timeframe (OECD Economic Outlook, 2005). The country has also showed budget excesses in nearly each year since the early 1990s (C. Mark, 2006). As a result, New Zealand's net debt has reduced considerably, from roughly 52% of GDP in 1992 to near 10% in 2005 (New Zealand Treasury, 2005.) During the same time, New Zealand has enjoyed, for the most part, moderate to strong economic growth, averaging around 3.3% annual growth in real GDP over the last decade (OECD Economic Outlook, 2005).



Source: OECD Economic Outlook No. 78 (2005)

Figure 1 New Zealand Real GDP Growth



Source: OECD Economic Outlook No. 78 (2005)

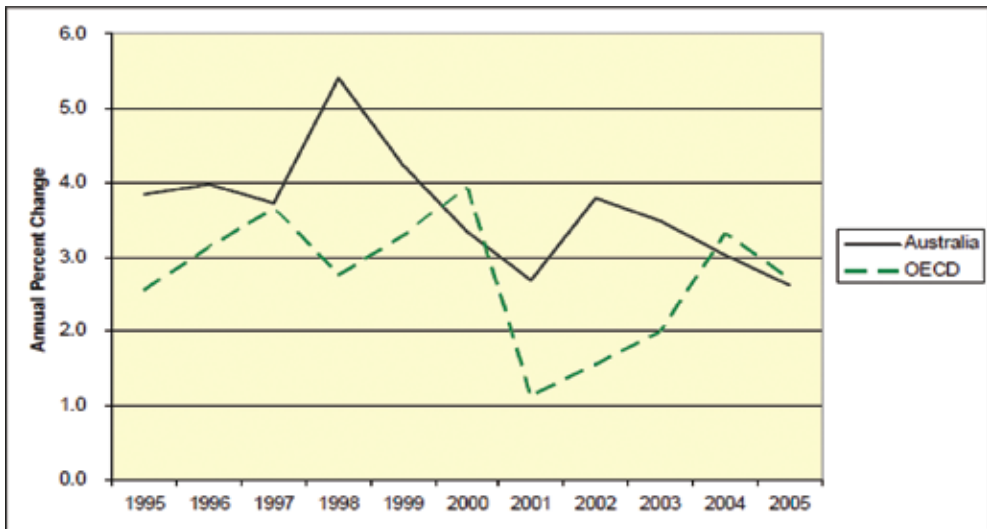
Figure 2 General Government Gross Financial Liabilities

2 *Australia*

A similar path with its neighbour, Australia’s embracing of accrual accounting for the public sector took place during a era of broad economic transforms, despite the fact that Australia’s migrations more cautious than New Zealand (C. Mark, , 2006). Albeit Australia’s economic development had been steadier than New Zealand’s, stress arose by the early 1990s to boost government capability and recover fiscal performance (GOA Report, 2000). Wide-ranging reforms were done all the way through two initiatives: the Financial Management Improvement Program and the Program Management and Budgeting (GOA Report, 2000).

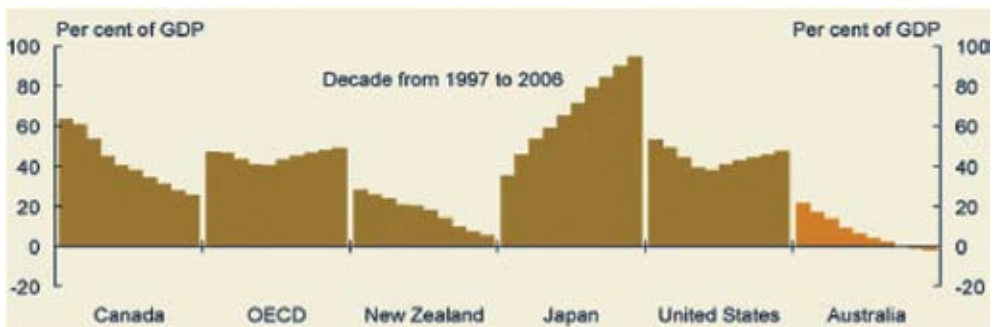
Moreover, the Financial Management and Accountability Act of 1997 launched a government management system with stress on performance evaluations contrasting with those adopted in New Zealand (C. Mark, 2006). Subsequently, government agencies were pushed to commence budgeting, reporting, and accounting on an accrual basis (C. Mark, 2006). The 1999-2000 budgets, Australia published comprehensive accrual-based financial statements and had wholly adopted accrual output budgeting (C. Mark, 2006). Start from that, Australia has continuous to develop its accrual-based accounting and budgeting.

In addition, Australia has reinforced fiscal controls in recent years. Australia has produced a budget surplus steadily close to a decade, and it has thrived in reducing its net debt from a high of 25% of GDP in the mid 1990s to near debt eradication (Australian Government Budget Overview 7, 2005). Its gross financial liabilities have reduced from a soaring of 43% of GDP in 1995 to 15% in 2005, the second lowest possible percentage in the OECD² (OECD Economic Outlook, 2005). Australia has benefited from economic growth in real GDP averaging 3.6% yearly over the past decade (OECD Economic Outlook, 2005). Once more, it is uncertain to what degree accrual accounting reforms are accountable for the fiscal control and economic growth.



Source: OECD Economic Outlook No. 78 (2005)

Figure 3 Australia Real GDP Growth



Source: OECD Economic Outlook No. 78 (2005)

Figure 4 Worldwide Comparison of Net Debt

² The Organization for Economic Co-operation and Development (OECD) (www.oecd.org)

3 *United Kingdom*

In the UK, which consists of four separate countries (England, Northern Ireland (NI), Scotland and Wales) within one main political unit, the migration from cash to accruals accounting for central government was viewed as major and highlighted as such by politicians. For example, Kenneth Clarke, the then UK Chancellor of the Exchequer, stated ‘people will find other ways of celebrating the millennium but few will be more important. This is one of those highly significant events’ (HM Treasury, 1995, p. 1).

A phased introduction, where systems were to be developed and resources, including skilled personnel, were to be acquired, was approved for the changes which were implemented under the title Resource Accounting and Budgeting (RAB). Resource accounting (RA) applies accruals principles to public sector accounting and seeks to combine objectives and targets into the accounting system. Resource budgeting involves using RA information as the foundation for planning and controlling public expenditure in order to make the management accounts support with the external accounts. The key events associated with the opening of RAB in the UK are outlined in Table 1. As can be seen, since the fiscal year 2003/2004 UK central government departments have been operating on an accruals basis for both accounting and budgeting. For a detailed discussion of this, and the actual implementation process, see Connolly and Hyndman (2006).

Table 1 Key events associated with the introduction of RAB in the UK

Year	Key Event
1994	Green (consultation) paper published by HM Treasury.
1995	White (policy) paper published by HM Treasury.
1998/99, 1999/00 and 2000/01	Dry run years for production of resource accounts.
1999	Dry-run exercise undertaken for resource budgets.
2001/02	Resource accounts fully implemented.
2001/02 and 2002/03	Resource budgets transitional years.
2003/04	Resource budgets fully implemented.

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 potential 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 & Loiselle-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 Bagues, 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 level accrual accounting transitions is accountable for economic growth and fiscal controls remain uncertain (Hepworth, 2003; Champoux, 2006; Zakiah &

Pendlebury, 2006). In the next section, this paper will further explain the impacts of accrual accounting reform as experienced by pioneer countries in accrual accounting adoption namely New Zealand, Australia and United Kingdom.

Impacts of Accrual Accounting Reform

Accountability has been the major motivation for governments to shift to accrual accounting as it is believed that accrual accounting will improve accountability (Chan, 2003). In New Zealand, the government adopted modern management practices which led to better performance and accountability in their public entities where chief executives are given stronger personnel authority (Champoux, 2006). The accountability of chief executives is not only limited to the financial management of their department, but also accountable for the financial results and financial performance of their organizations. This has been made possible by implementing performance-based executive evaluations where the chief executives have annual performance agreements within a limited-term employment contract (Ball et al., 2004). They are held accountable for the outputs stated in the agreement and financial mismanagement will then reflect their performance assessment at the end of each period (Ball et al., 2004).

Both New Zealand and Australia showed a better fiscal performance since the introduction of accrual accounting as Champoux (2006) reported that both countries have produced a budget surplus in nearly every year. He then further explained that Australia has thrived in dipping its net debt from a high of 25% of GDP in the mid 1990s to near debt elimination and benefited from constant economic growth in real GDP over the years. New Zealand on the other hand has succeeded in decreasing its gross financial liabilities from 65% of GDP in the early 1990s to 23% in mid 2000s. This led a remarkable decrease in New Zealand's net debt. Similarly, New Zealand has enjoyed moderate to strong economic growth in real GDP over the years.

Following the introduction of accrual accounting, there were significant improvements in asset management (Baboojee, 2011). For instance, the UK government was able to use accrual accounting information to identify under-utilized assets and to dispose those assets that were no longer in use (Wynne, 2010). The detailed information provided by accrual accounting allowed them to understand how well they are using their financial resources especially in asset and liabilities management (Arnaboldi and Lapsley, 2009; Lapsley et al., 2009; Wynne, 2010, Baboojee, 2011). This happened similarly in Australia as they managed to sell off their under-utilized and obsolete assets and caused the Australian government to receive millions of revenue generated from the asset disposals in mid 1990s (Barton, 2009). The improved quality of information provided by accrual accounting made this possible and also aid in decision making for assets acquisition (Ball et al., 2004).

4 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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