

EXTERNAL REPORTING OF PUBLIC INSTITUTIONS OF HIGHER LEARNING IN MALAYSIA: AN EMPIRICAL INVESTIGATION

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

Public sector organisations have a stewardship function, which means that they have to ensure that the public assets, which they manage, have not been misappropriated and that all expenditure is proper and correct (Wynne, 2002). Thus, the public assets must be spent according to the authority's budget and as specified by the government regulation or legislation. Public sector organisations are also accountable for the way in which public monies are spent. They should be held to account for the quality, efficiency and effectiveness of the services they provide (Wynne, 2002). The electorates of the public sector consist of the citizens, investors and the government as the overseeing bodies.

Public universities comprise one relatively homogeneous group of statutory bodies¹ (Cameron and James, 1993). Public universities, like any other statutory bodies, have the responsibility to demonstrate that the public assets, which they manage, have been spent in accordance with the authority's agreed budget and by conforming to the authority's financial regulations and other regulatory and legal requirements. Public universities are also accountable for the way in which the public monies are spent. They must be accountable in demonstrating that their activities, which largely concentrated on providing education, are efficiently and effectively managed.

According to Patterson (1989) demand for universities to fully account for their operation and expenditures is due to greater public interest in the universities and heightened awareness of competing demand on scarce public funds from government itself and from the providers of funding (Coy, Dixon and Tower, 1992). Accountability means the obligation to give an account (Perks,

¹ In public sector in Malaysia, statutory bodies are those government organisations set up under Statutory Act 1980.

1993) and is often referred to "as the requirement for one party to account to another party for its performance over a given period" (Coy, Fischer and Gordon, 2000).

Universities are accountable to internal and external parties of the institutions. At the internal level, the university president is directly accountable to the governing board. Similarly, accountability mechanisms within the external world exist through the auditors, governing board, advisory boards and the general responsiveness of institutions to public and media enquiries (Coy et. al, 2000).

Walker (1988) stated that annual reports generally are regarded as primary vehicles by which entities communicate information about their activities to their stakeholders and so fundamental to discharging accountability (Coy et al., 1992). Therefore, in a society in which accountability is a part of the way of life, reporting publicly is a responsibility incumbent on every economic entity, which is significant in terms of its command over human and material resources (Gray, Owen and Mauders, 1987). The value of the annual report rests in the provision of a wide range of summarised, relevant information in a single document, which enables stakeholders to obtain a comprehensive understanding of a university's objective and performance in financial and non-financial items (Coy et al., 2000).

Accordingly Wynne (2002) stressed that an authority's financial statements and especially the audit report are key to the authority fulfilling its stewardship function. Furthermore according to Wynne (2002) for a public sector organisation to adequately fulfil its accountability responsibilities, it needs to produce suitable financial statements and also to report on the range of and quality of the services that it has provided. Thus in the case of public universities, the financial statements must be able to convey information in the same manner.

1.2 DEVELOPMENTS REGARDING UNIVERSITIES' EXTERNAL REPORTING

1.2.1 INTERNATIONAL DEVELOPMENT

Australia

Australian public universities have reporting obligations to dependant users and thus must apply all Australian accounting standards when generating annual reports (Hancock, Tower and Holloway 1994). Department of Employment Education and Training (DEET) Australia also requires financial report to be prepared in accordance with all Statements of Accounting Concept and Australian Accounting Standards and other requirements set out by legislation or some other authority (Nelson, Tower, Banks and Fisher, 1997).

Canada

Canadian public universities' annual report is governed by the 1997 exposure draft that was issued by the Canada Institute of Chartered Accountants, which propose new disclosures for Not-for-Profit organisations including universities (Nelson et al., 1997). Additionally, the Canadian Comprehensive Auditing Foundation (CCAF, 1993) published an accountability framework based on colleges and institutes in British Columbia (Nelson et al., 1997).

New Zealand

Professional recommendations such as issued by the New Zealand Society of Accountants (NZSA)² and legislation such as Education Amendment Act in 1990 recognized the importance of the accountability of government entities including the universities. There has also been a change in emphasis in accounting regulation in the sense that information for decision-making has declined in importance as the objective of public sector organisation whilst information to demonstrate accountability has increased in importance (Coy and Pratt, 1998).

² Statement Of Public Sector Accounting Concepts (PSAC)(NZSA, 1987) requires public sector entities to prepare and publish external financial reports, which should reflect specific policies and criteria for the allocation of resources, the efficiency of public administrator and for the effectiveness of welfare delivery.

United Kingdom (UK)

United Kingdom universities' external reporting are governed by the 1989 Statement Of Recommended Practice Of Accounting in UK universities (SORP1) (Committee of Vice Chancellors and Principals, 1989) and SORP 2 (1994) (Nelson et al., 1997). Both SORP had provided a bridge from decision making to accountability as the objective of university accounting (Nelson et al., 1997).

United States of America (USA)

The Governmental Accounting Standard Board (GASB) Concepts Statements No 1 stated that the objectives of financial reporting for government entities are to provide information for both decision- making and accountability assessment (Nelson et al., 1997). However, the accountability is the paramount objective from which all other objectives must flow (Engstrom, 1988).

Summary of International Developments

From the international scene, it is evident that there is an important emphasis on accountability as the objective of the public sectors reporting as well as public universities reporting. Thus in order for the public universities' annual reports to satisfy this objective, the information disclosed should be of a nature of accountability information.

1.2.2 LOCAL DEVELOPMENT

In Malaysia, external reporting of public institutions of higher learning is governed by Statutory Bodies (Accounts and Annual Reports) Act 1980. This Act basically provides certain time limits in relation to the preparation and submission of the statements of accounts for audit of all statutory bodies incorporated pursuant to the provisions of federal law and the audit of such accounts, the preparation and submission of the annual reports of the activities of all such statutory bodies, for the tabling before each House of Parliament of such audited statements of accounts and such annual reports, and for matters connected

therewith. The Act³ also requires all statutory bodies to account for their transaction in accordance to Generally Accepted Accounting Principles (GAAP) in order to show true and fair view of the operations of the statutory bodies. In Malaysia, the GAAP applicable would be the standards as prescribed by Malaysian Accounting Standard Board (MASB)⁴.

The guidelines for the format of the annual report are specified in Treasury Circular No 15, 1994⁵ with the purpose of ensuring that the annual reports of all statutory bodies will satisfy objectives, among other things, to enhance the public accountability of the statutory bodies. Thus in applying this to Malaysian universities, their annual reports must show accountability of the universities.

1.2.3 SUMMARY OF DISCUSSIONS

It is been a common consensus among the regulators both internationally and locally of the importance of universities' external reporting to satisfy the public accountability.

With all these regulations and guidelines in existence that emphasise the accountability objective, a need arises to assess to what extent current external reporting practices satisfy this objective.

1.3 RELATED LITERATURE REVIEW

1.3.1 INTERNATIONAL

Australia

Cameron and Guthrie (1993) carried out a longitudinal case study of the University Of New South Wales annual reporting practice from the period 1950 to 1988 in order to examine the possible links between changes in internal and external factors to changes in annual reporting practices of the university.

³ Section 5(1) Statutory Bodies (Account and Annual Report) Act 1980

⁴ MASB was established under the Financial Reporting Act 1997 that aims to improve the quality of external reporting and contribute to the international development of financial reporting

⁵ Treasury Circular is issued by Treasury Department in Malaysia to give guidelines in matter concerning statutory bodies.

Nelson, Tower, Banks and Fisher (1997) examined empirically the disclosures in the annual reports of Australian public universities from the period of 1993 to 1995 and revealed that annual report of the universities still lacking public accountability information.

Canada

A review and examination of the financial statements and annual reports of Canadian public universities suggested that they have a long way to go to demonstrate public accountability beyond minimum levels (Nelson, Fisher and Banks, 1998).

New Zealand

Many studies were conducted by Coy, Tower and Dixon throughout the year 1993 to year 2002 in assessing the quantity and quality of disclosure information of New Zealand universities' annual reports and concluded that there is an "overall upward trend in quality of annual reports of tertiary education". A study in New Zealand by Dixon, Coy, Buchanan and Fry (2002) also identified the recipients of public universities' annual reporting and assess their expectation on the annual reports. Dixon et al. (2002) stated that university annual reports now compare favourable with those from other sectors despite the existence of some important gaps. According to Dixon et al. (2002) the university annual reports have improved immensely over the past decade or so.

United Kingdom (UK)

Gray and Haslam (1990) examined British universities' corporate reports and concluded that external forces had a marked effect on reporting practices. Banks and Fisher (1997) revealed that there has not been a statistically significant change in the quantity and quality of disclosure of annual reports of the UK universities despite many changes in the structure and organisation of higher education in UK together with the granting of corporate status to educational institutions.

United States Of America (USA)

A study by Konrath (1976) concluded that annual reports of universities and colleges were clearly inadequate with respect to both fiduciary and resource utilization reporting. Peat Marwick Mitchell & Co (1985) indicated that financial reports issued by college and universities were heavily criticised by its users. Another study conducted by Engstrom and Fountain (1989) identified the users of universities' annual report. Fischer and Gordon (1991) revealed that many institutions have not adequately considered the objectives of their public reports, the target audience for the reports and how the reports could meet the needs of external users. Gordon, Fischer, Malone and Tower (1997) revealed that public colleges and universities' annual report have low level of disclosure reporting.

1.3.2 LOCAL

University of Science Malaysia (1999) conducted a research that concentrated on the fees charging in IPTA⁶. A comparison analysis of fees between IPTA and IPTS⁷ was made to assess the accountability of the IPTAs' as well as its degree of competitiveness to IPTSs⁸.

A study done by Shireenjit Kaur John (1993) in examining the financial reports of government entities in Malaysia provided empirical evidence that financial reports by government entities in Malaysia lack financial accountability.

1.3.3 SUMMARY OF DISCUSSIONS

By looking at both international and local scene, we can see that there is a link between public universities and public accountability. Internationally, it is been a practice to assess the annual report of the universities as an indication of public universities' public accountability. Studies in these various countries,

⁶ IPTA is an abbreviation of "Institut Pengajian Tinggi Awam" or public institutions of higher learning in Malaysia. They are established under University Act And College Act, amended in 1997, excluding one international university that was established under the Malaysian (Company Act) so as to allow the university to use English as the medium of instruction

⁷ IPTS is an abbreviation of " Institut Pengajian Tinggi Swasta" or private institutions of higher learning in Malaysia.

⁸ Currently a five-month research is conducted by Atarek Kamil Ibrahim & Co, a public accounting firm in Malaysia under the supervision of Ministry Of Education in order to compare the cost per students in IPTA and IPTS.

except for New Zealand universities, highlighted the lack of public accountability approach in external reporting of universities despite various legislations and guidelines by both accounting profession and overseeing bodies. Thus it would be to our interest to assess to what extent Malaysian public universities' annual reports satisfy the public accountability framework. Empirical evidence is needed to show whether external reporting of IPTA in Malaysia lacks financial accountability as evidenced by financial reports of other government entities.

1.4 PROBLEM STATEMENT

In Malaysia there are currently 17 IPTA, which activities are largely funded by government grants and are administered by Ministry Of Education under the Federal Government. These 17 IPTA include 11 public universities and 6 college universities, which provide education to more than 200,000 students in Malaysia (Berita Harian, August, 2002).

On 20 July 1994, corporatisation of public universities was proposed by Ministry Of Education in order to increase the accountability as well as the efficiency of public universities (Skudai Post, UTM, 1997). The idea behind the concept is to encourage universities to adopt a more business-like approach in conducting their activities. This to reduce their dependency on government's grants and rely more on their own generated income in order to finance their activities.

According to Education Ministry, by year 2010, at least 30% of universities operational budget must be self-generated by the universities (News Straits Times, 2001). As public universities are required to generate their own of income, there is a need for the universities to display their performance in a manner that can be used by the interested parties, which can be potential donors or students, in order to assess the performance over time or over industry. Coy, Dixon and Tower (1993) stated that a measure of disclosure in tertiary education institutions (TEI) annual report could act as an easy indicator of disclosure that might be used by stakeholders and also a measure that could be used in the performance evaluation of the preparers. A study in UK had shown the granting of corporate

status to the universities had not changed the practice of annual reporting, thus it would be of our interest to see whether the same thing happen in Malaysia.

The emergence of many private institutions of higher learning (IPTS) in Malaysia has also brought about the need for better accountability of public universities. "Issues such as accountability to students, meeting the needs of industry and other employers, maintaining academic standards and financial accountability to the government and funding bodies will attract increasing attention as competition between institutions for students become more severe" (Williams and Loder, 1986, page 2).

Hence the quality of the annual reports of the public institutions of higher learning would be of importance to both preparers and users as "improved accounting may therefore educate users and enable them to develop firmer opinions on their needs and take a greater interest in the operations of public institutions"(Nelson et al., 1997). There is no prior study known to author that evaluating and assessing the accountability of external reporting by public institutions of higher learning in Malaysia. This lack of empirical evidence under the Malaysian context was a major motivator to carry out the study.

This study therefore is important in that it examines the presentation and extent of financial and non-financial information provided by Malaysian public institutions of higher learning. Additionally, "the use of disclosures indices may encourage institutions to improve the quality of annual reports. If better disclosure increases accountability to stakeholder and if this leads institutions to change their behaviour such stakeholders obtain greater benefits from them, the better quality reports should lead to more effective institutions" (Coy et al., 1993).

1.5 RESEARCH OBJECTIVE

This study is mainly focused on exploring the external reporting of the public institutions of higher learning (IPTA) in Malaysia. Hence the objective of this study is to examine the current practice of IPTA annual reporting in Malaysia. The study also try to shed some light on the current use of annual reporting of public universities in Malaysia and also to identify the existence of any

expectation gap between users opinion of information that is currently reported in the annual reports and information that they would like to be included in the annual reports. Subsequently this study would try to recommend other information that should be included in the annual reporting of the IPTA to adequately fulfil its public accountability objective.

1.6 MODEL FRAMEWORK FOR PUBLIC INSTITUTIONS OF HIGHER LEARNING'S EXTERNAL REPORTING

The objectives of general purpose financial reporting in the public universities are to provide information useful for decision-making, and to demonstrate the accountability of the entity for the resources entrusted to it. The users of this annual reporting can be classified into six categories. Refer to Figure 1.6(a).

Figure 1.6(a) Users Of Public Universities' Annual Reports

Internal Campus- based Citizens (a)	Elected/ Appointed Representatives (b)	External Off Campus Citizens (c)	Sister Organisations/ Competitors (d)	Resource Providers (e)	Public/ Analyst And Media (f)
Academics	Government And Regulators	Advisors And Consultants	Employees Of Other Institutions	Ministry Of Education	Journalist
Support Staff	Parliamentarian	Alumni		Donors/ Sponsors	Public At Large
Corporate Managers	Boards Of Directors	Other Pressure Groups		Investors/ Partners	Researcher And Analysis
Students	Accreditation Agencies	Service Recipients (excluding students)		Professional Associations	Voters And Taxpayers
	Advisory Committee Members			Suppliers/ Creditors	

(Source: Coy, Dixon, Buchanan and Tower, 1997, Dixon et al., 2002)

Figure 1.6(b) Qualitative Characteristics For Public Universities External Reporting

1. Timeliness
2. Benefits > Cost
3. Understandability
4. Relevance
5. Faithful representation
6. Predictive value
7. Reliability
8. Decision Usefulness
9. Neutrality
10. Verifiability
11. Comparability
12. Consistency

(Source: Coy et al., 1997, Dixon et al., 2002, MASB, 1998)

1.7 RESEARCH METHODOLOGY

Based on prior research conducted in Australia, Canada, New Zealand and UK, the annual reports of the 12 IPTA in Malaysia for the two years period i.e. from 1999 to 2000 are examined. The objective of this research is mainly to highlight the disclosure items in the financial statements. This is to investigate whether public universities financial reporting discloses items as required by the model framework. If the items are presented the universities are considered to disclose the items.

In order to determine the degree of disclosure of accountability information, a disclosure index comprising items called Modified Accountability Disclosure Index (MAD)⁹ that previously used in similar work in Australia, Canada, New Zealand and UK is used. Each annual report is examined and the items included in the MAD index were scored. If the item is absent, the report received a score of zero. If the item is present, it scores on an ordinal scale

⁹ MAD was developed by Coy, Dixon and Tower for the study of New Zealand public universities' annual report in 1991 and was later revised to overcome its weaknesses in similar study in 1993 and 1994. Coy and Dixon further revised the method in 2002 and presented a new method called Public Accountability Index

based upon the perceived quality of the disclosures with scores ranging from (1) poor to (5) excellent. The items chosen by Coy et al. (1993,1994) for their MAD index were determined primarily through a review of the accountability literature for universities and through analysis of current annual reports (Banks and Fisher, 1997).

Even though it was developed to evaluate university disclosures in New Zealand, many of the items are consistent with the requirements as set by Treasury Circular No 15,1994¹⁰ in Malaysia.

In recognising some items that are perceived to be important than others, a subjective weight is developed for each item. The weights used are on ordinal scale of low importance (1) to medium importance (2) and high importance (3). The items then are aggregated using the weights to arrive at the overall MAD index score out of 100 of each university.

For the purpose of identifying the uses of public universities annual report, questionnaires is designed and sent to users of the annual reporting. Dixon et al. (2002) stated that the interest in annual report is great among people located on university campus with governance or managerial position, however among students, annual report usage continues to be very low and interest among academics without much managerial responsibility is not as great among people in managerial or governance positions, be they academics or non-academics.

Accordingly Dixon et al. (2002) stated that most recipients of the annual reports continue to be in (a), (b) and (d), being people located on university campuses or serving as university council members, mostly receiving and using their own university's annual report but in addition, many of them receiving and using the reports of the other universities. Based on this finding and taking into account the purpose of this research is mainly to identify the uses of the annual reports, the target sampling for the questionnaires would be limited to managements of the universities that consist of the Vice Chancellor, Financial Controller/Bursar and Registrar of the universities and also Members of Board Of

¹⁰ Treasury Circular No 15,1994 specified that annual report of a statutory body must have corporate information, background of the statutory body, chairman statement, report on the government grant, financial analysis, report on the performance and financial statements that have been audited.

Directors of each IPTA in Malaysia. Additionally, as the influence of annual reports on the activities of governing bodies that supervise and also allocate resources for the activities of the IPTA would be of interest, Ministry of Education (MOE), which administer universities activities would also be the target sample.

The main part of the questionnaire will be devoted to sections, which asked about the qualities and disclosures of the reports. These questions will be designed in order to identify any expectation gap.

1.8 LIMITATIONS

The MAD items and score was developed form the researchers subjective judgements about the items to include and weights attach to them (Coy and Dixon, 2002). Furthermore the MAD was developed for New Zealand universities environment and was applied to similar studies in Australia, Canada and United Kingdom.

Additionally the MAD score included report disclosures only and yet it was apparent that report qualities such as timeliness had an important influence on external reporting (Coy and Dixon, 2002).

Furthermore the questionnaires were not meant to identify the users but only to identify the uses of the annual reports. The questionnaires were mainly distributed to parties that have been identified in many prior studies and again a subjective selection was made to choose only a few groups of the identified users to participate in the questionnaires. Important groups such as potential students and students are ignored despite being the largest recipients of universities' service.

1.9 ORGANISATION OF THE STUDY

The project will be presented in five chapters as follows:

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|----------------|--|
| Chapter One: | Introduction (An Overview of the Research Project) |
| Chapter Two: | Literature Review |
| Chapter Three: | Research Methodology and Methods |
| Chapter Four: | Research Findings |

Chapter Five: Conclusion. Provides recommendations for future research.

1.10 CONCLUSIONS

This chapter provides an overview of the study. It explains the reasons for, and the purpose of this study. The next chapter will review both overseas and local accounting literature pertaining to disclosures of universities external reporting.