

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

Chapter One gives an overview of the objectives of this study. This chapter provides the background and the rationale of the study. It also attempts to identify gaps between the reviewed literature and the current situation of universities annual reporting.

2.2 OVERSEAS PRIOR STUDIES

Several studies on external reporting of universities were conducted in Australia, Canada, New Zealand, UK and USA. Most of the studies examined the extent of disclosures of accountability information in universities annual reports in order to satisfy the public accountability requirements.

2.2.1 Studies In Australia

Cameron and Guthrie (1993) carried out a longitudinal case study of the University Of New South Wales that focused in examining variables that could influence university annual reporting. Cameron and Guthrie identified management, preparers and internal users as internal factors that could influence the changes in external reporting of universities in Australia. Other internal factors such as size and the proportion of government grants could also influence the reporting practices of the universities. However, these variables were not examined in this study.

But, beside the three internal factors that were identified, this study also examines the impact of external factors like legislation and regulation, parliamentary and government activities, Department of Finance directives, Auditor General directives and opinion, private sector professional standard setters, other universities' practices, overseas practices and general users of annual reports to universities annual reporting. Their study suggests that in Australia, the universities annual report is significantly influenced by internal

factors with the exception of state government legislation. The study also highlights that increasing prominence is given to financial information and the constant use of performance indicators over the whole period.

Next, Nelson, Tower, Banks and Fisher (1997) examined empirically the disclosures of accountability information in the annual reports of Australian public universities from the period of 1993 to 1995. Nelson et al. (1997) emphasized on accountability as the objective of universities annual reporting. The disclosure of accountability information of universities annual report was examined against the MAD index, which was applied by Coy et al. (1993,1994) in their study of New Zealand universities disclosure.¹¹ The study revealed that annual reports of Australian universities lack quantity and quality of disclosures and still has a long way to go to extend public accountability beyond the minimum that is recommended by accounting practice, especially items that relate to service performance.

Nelson et al. (1997) also noted that failure to provide adequate important information such as statement of objectives or students' numbers would make it difficult for stakeholders to make intelligent judgements about the success of the universities in meeting their objectives. Nelson et al. (1997) also concluded that quantity and quality disclosure levels of Australian universities' annual reports in Australia universities were below those of the New Zealand universities but above the Canadian and UK universities.

Study by Cameron and Guthrie (1993) highlighted the fact that internal factors are the major influence on universities' annual reporting practices in Australia. However, state government legislation that is based on accountability framework has also significantly affects the annual reports of Australian universities. Universities are expected to disclose accountability information in their annual reports. But empirical evidence as shown in study by Nelson et al. (1997), the disclosure is still not adequate in fulfilling the accountability requirements. This is might be due to the fact that the preparation of the annual

¹¹ The MAD used was determined through a review of the accountancy literatures and also by analysing the current annual reports (Nelson et al., 1997).

reports are influenced by managements, preparers and internal users (Cameron and Guthrie, 1993) who may already have other reports such as budget or management reports and may not require comprehensive annual reports.

2.2.2 Studies In Canada

Cutt (1993) indicated that public concern for accountability of universities goes beyond the traditional concern for integrity in the use of public resources but extend to assurance that universities are achieving their objectives as effectively as possible. Nelson, Fisher and Banks (1998) carried out a study to determine university accountability by examining audited financial statements and annual reports of between 42 and 44 universities in Canada from the period of 1990 to 1996. Similar to the study in Australia, the study focused on disclosure of accountability information. The findings of this study were compared by the same researchers to the disclosure of universities in Australian context.¹²

It was observed, like in Australia, the Canadian universities disclosures still has a long way to go if it were to extend public accountability beyond the minimum that is recommended. Nelson et al. (1997) commented that overall disclosure by the universities was virtually unchanged for the seven-year period despite the changes in business environment and called for greater public accountability.

Mc Crindell and Roy (1998) suggested that in order to enhance accountability in the public sector¹³, it must be able to demonstrate and take responsibility for performance in light of agreed-upon expectation. Additionally it was argued that for performance information to be effectively rendered information on the cost of the services must be included and subsequently better accountability would arise if better costing system that lead to higher quality of performance information were adopted (Mc Crindell and Roy, 1998).

In consistent with the Australian study, there was a call for Canadian universities to be more accountable. Thus, studies relating to Canadian

¹² The study in Canada was done by the same researchers who did the similar study in Australia, excluding Tower.

¹³ Public universities representing a homogeneous body of statutory bodies (Cameron and Guthrie, 1993)

universities also deal largely with this issue. Arising from the accountability issue, more information on the universities' performance measurements is required to be disclosed in the annual reports.

2.2.3 Studies In New Zealand

Coy, Dixon and Tower (1991) did an early study on the seven New Zealand universities by examined their annual reports from the period of 1985 to 1989. The practices and trends of the external reporting was analysed against domestic influences such as the New Zealand Society of Accountants' (NZSA) public sector accounting concepts statements. Coy et al. (1991) found that no apparent relationship exists between the size of the institutions and the level of reporting practices. The study also indicated that the current reporting practices of the university lacked in information such as separate accounting for research. The study also revealed that only two New Zealand universities had made an effort in improving disclosure in their 1989 annual reports in line with NZSA requirements, which emphasizes on accountability. However, other universities had made little change.

Coy, Dixon and Tower (1993) continue to examine the disclosure of annual reports of tertiary institutions for 1990 and 1992. The reports are analysed by using a method called the Accountability Index (AD) score. Annual reporting of 33 New Zealand tertiary education bodies were analysed using the AD score. According to Coy et al. (1993), a measure of disclosure in tertiary education institutions (TEI) annual reports will bring benefits as it is an easily understood indicator to be used by stakeholders and it will also encourage institutions to improve their quality of annual reports. The AD method was then modified in the next study in 1994, which showed that there is a general trend of more and better quality disclosure than the previous study. In 2002, the MAD¹⁴ index is again revised by Coy and Dixon. The new method adopted is called Public Accountability Index (PAI) that has parametric statistical properties to measure the public accountability of the annual reports of universities. Coy and Dixon

¹⁴ Modified Accountability Disclosure Index

(2002) argued the method is more superior as they are developed from stakeholders' opinion. However the PAI is specific for New Zealand universities and some modification would be needed to apply to university annual reports in other countries (Coy and Dixon, 2002).

A further study relating to annual reporting by universities (Tower, Coy and Dixon 1994) focuses on preparers' perspective on annual reporting of universities. They examined four factors, which brought about the changes in reporting quality, namely the attitude of the CEO towards the annual report, commitment of the tertiary education institutions to staff development and training, initiatives taken by senior staff and particularly those with accounting responsibilities and legislation and other regulatory measures. The study shows that the role of the CEO and the skills and energy of senior managers were crucial influences on the quality of annual reporting whereas external pressures would come in the form of other tertiary education institutions, audit staff and the audit office in New Zealand.

Another related study by Coy, Dixon, Buchanan and Tower (1997) explores the users and uses of public sector annual reports. Besides identifying the users and uses of universities annual reports, the study also assessed the existence of expectation gap between information that is currently reported and information that users expect to be reported in the annual reports. Coy et al. (1997) identified six categories of recipients of annual reports of TEI and concluded that most significant category of report recipients were people located on TEI campuses, including employees of similar TEIs. It was also revealed that students represented the smallest number of recipients despite being the largest service users of the university. The study shows that there is an average expectation gap of almost one point in quality and two thirds of one point in disclosures. The recipients found actual reports failing most short in respect of decision usefulness and believed that the reports were more biased towards managements of the universities. In terms of disclosures, the common opinion of the recipients was that the report lacked future oriented, efficiency, and

effectiveness information of the universities. Despite being the smallest recipients, students' expectation gaps were about twice those of other recipients.

Dixon, Coy, Buchanan and Fry (2002) found that the most significant recipients of the annual report continue to be people located in campuses, most of them receiving and using their own universities report but in addition many of them receiving and using the report of other universities. Among the students, however, the usage of the reports continues to be very low. Dixon et al. (2002) also noted that annual reports are used for making decisions in the course of performing tasks and activities and for holding governors and managers to public account. Most respondents agreed that to a certain extent, the annual reports are useful.

Accordingly Dixon et al. (2002) concluded that there is a narrowing gap between expectations and achievements in qualitative characteristics of decision usefulness, relevance and predictive value but wider gap for items such as comparability with other institutions and research activities. The improvement in the decision making and the greater use of the recipients for this purpose reflects the emphasis of objective of reporting as decision making however, according to recipients and consistent with regulations through out the years, public accountability is still significant objective of universities annual reporting (Dixon et al., 2002)

Extensive researches on universities annual reports have been done in New Zealand with areas ranging from the preparers and users perspectives on the annual reports and also the current practice of external reporting. MAD method used by Coy et al., (1994) in their study has provided a significant measure of disclosures and is used in other studies in various countries. The New Zealand studies indicated that universities annual reports have improve immensely over the past decade or so (Dixon et al., 2002) in achieving its accountability objective although some important gaps remain.

2.2.4 Studies in United Kingdom

In United Kingdom, Gray and Haslam (1990) examined British universities' corporate reports over a period of five accounting years from 1982/83 to 1986/87. The study was aimed at exploring the accounting changes that affect the external reporting of the universities. Gray and Haslam (1990) examined the impact of external forces in the form of financial disclosure recommended by Committee Of Vice Chancellors and Principals (CVCP) 1984, voluntary disclosure of financial information, various information as suggested by Jarratt report¹⁵ (CVCP, 1985) and voluntary disclosure of non-financial/qualitative information. The authors concluded that UK universities external reporting practices have responded to the prompted financial disclosures as suggested by CVCP (1984) but Jarrat report (1985) has not had the significantly same effect. But the existence of unstable environment and a move towards a more focused but less specific reporting has brought changes in voluntary disclosure.

Banks and Fisher (1997) used MAD index to examine the quality of disclosure of accountability information in annual reporting of UK public universities. This study was taken in the wake of the major cuts of government grants announced by the government as well as the conversion of many polytechnics and other higher educational institutions to universities which bring about a change in funding arrangements of the universities with the establishment of three territorial founding councils in placed of a single funding body and also the granting of corporate status to educational institutions. Due to these factors, universities are forced to change their governance structure and faced with higher competition for scarce resources and new funding patterns.

These situations require universities to provide information that can be used in decision making of the potential donors as well the accountability of the universities. But the study 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 the changes as mentioned before. It was also

¹⁵ This is the report of the Steering Committee for Efficiency Studies in Universities under the Committee of Vice Chancellors and Principals chaired by Jarrat, A.

revealed that in overall, UK universities' annual reports lack service performance information. Banks and Fisher (1997) stated that the failure to adequately disclose key performance indicators points out the need to further disclosure changes if universities are to satisfy increasing demands for greater public accountability.

The early study had indicated annual reports of UK universities are gradually changing due to government regulations. Subsequently UK universities' annual reports are also expected to change due to the change in environment. The objective of annual reporting as prescribed by the CVCP in UK is to ensure accountability of the universities, however, the current practice is still lacking information especially on service performance which form an important item in accountability.

It is interesting to note that Malaysian universities are now facing similar environmental developments as in UK in which there is a reduction in government grant, the granting of corporate status to universities as well as higher competition for funding.

2.2.5 Studies in United States of America

Konrath (1976) stated that tax-supported colleges and universities are experiencing increasing demands from governing boards, legislatures, regents and the public in general for greater accountability. He did a survey of 88 annual reports of public universities and colleges to ascertain the degree to which the colleges and universities are meeting this need for providing relevant information. Konrath (1976) concluded that the reports were clearly inadequate with respect to both fiduciary and resource utilization reporting. He also suggested that in order to make universities report meaningful, research is necessary to develop and articulate a concept of relevance to meet the growing need for more informative financial reporting by colleges and universities. His suggestion has led to researchers such as Henke and Conway, Jr who recommended reporting format for college and university financial statements in 1989. In relation to Malaysian universities, no similar study has been done. Thus this study would be

a starting point for Malaysian to develop more relevant and reliable format for universities' annual reports.

Additionally, a US survey that involved 598 colleges and universities by Peat Marwick Mitchell & Co in 1985 revealed that respondents to the survey were quite critical of financial reports issued by college and universities. They felt that the reports did not relate to the institution's missions, goal and objectives.

The objectives of financial reporting of public sector as stated by Government Accounting Standard Board (GASB) are to be accountable and to enable users to assess the accountability of the public sector (Henke and Conway, Jr, 1989). The primary financial reporting for a non-profit organisation (such as a university) should be to disclose the service story of the organisation that indicated the efficiency and effectiveness of the operations conducted by the organisation.

A study done by Engstrom and Fountain (1989) in USA identified 13 groups of financial users of universities' annual report. These include higher education executive officers and state budget officers and auditors. Engstrom and Fountain (1989) emphasized on the decision-making as the objective of universities annual reports.

Fisher and Gordon (1991) stated that the annual report should provide the reader with enough information to understand the nature of the institutions and something about its mission. Fisher and Gordon (1991) commented 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. They recommended that college and university annual reports should report on the ratios as means of comparison over time and over industry.

Gordon, Fischer, Malone and Tower (1997) conducted a study that examines the 1994 annual reports of 100 US private and public colleges to determine identifiable and measurable factors associated with extent of disclosures. The absence of performance information in the majority of 1994 colleges and universities suggest that they have adopted a limited view of their public accountability obligations (Gordon et al., 1997).

Fischer, Gordon and Coy (2000) did a study to examine the purpose of external reporting by universities. According to Fischer et al., (2000) financial reporting at the beginning of the twenty first century is based on decision usefulness paradigm that provides information for the purpose of making economic decisions. However, the researchers argued that colleges and universities external reporting should move beyond decision usefulness to public accountability approach as it would include important features of stewardship perspective and also the decision usefulness perspective. The change would also acknowledge the existence of wider audience of the annual report and potential interest in disclosing more information. Fischer et al. (2000) also recommended that disclosures about teaching, research, service efforts and accomplishments and resource and overhead allocations should be included in the annual reports. Additionally, based on the accountability-based framework, the annual reports should have the qualitative characteristics of fairness, accessibility and distribution.

Universities annual reporting in the US is changing throughout the years. Recently, there is a strong emphasis on accountability. Despite many criticism and recommendations on the contents of the annual reports, empirical evidence suggested that the annual reports are still inadequate in fulfilling the accountability requirements.

2.2.6 Summary Of Discussions

Studies in these countries have implied that “universities accountability” is of interest to various parties such as the government and public in general. The studies also indicated that the objectives of universities annual reporting are for decision-making and to satisfy accountability to the public. A recent study by Dixon et al. (2002) proved that more users are using the annual report for decision-making, although they still consider information on public accountability of the universities is important.

In all the countries mentioned above, conceptual framework of universities annual report is derived on the public accountability framework. However, the

adoption of MAD indexes in many of these studies had shown that universities disclosure does not adequately satisfy the public accountability requirements. This view is consistent with the opinion of the users of the universities' annual reports. They are still expecting the annual reports to have more information that can be used by them in making rational decisions about the allocations of resources to those institutions and also information that shows the institutions are effectively and efficiently managed. Most researchers also suggested that information on service performance of the universities would satisfy the accountability framework.

Thus in view of public accountability of universities, the area that are of interest is the form and basis of external reports and the issue of performance assessment. In order for universities to respond to changes in the environment either from the rising criticism from the public on their performance or rising need to find funding sources, they should provide more comprehensive annual reports that will help users in making decision as well as displaying universities performance in comparison with other institutions.

2.3 LOCAL PRIOR STUDIES

Shireenjit (1993) studied accountability of public sector in Malaysia by examining 62 financial reports of government entities in Malaysia ranging from federal, state and local level. Shireenjit examined the relationship between size, long-term debt and the form of government to level of disclosure reflecting financial accountability. The study proved that there is a significant relationship between long-term debt and form of government to level of disclosure reflecting accountability. But Shireenjit found insignificant relationship between size in terms of assets and revenues to level of disclosure in the financial reporting.

In context of public universities in Malaysia, in 1999, University of Science Malaysia conducted a research, under the direction of Higher Education Research Institute (under Ministry Of Education) with the purpose of identifying the fees charged to IPTAs' students. The study highlighted the fact that 80% of the expenses incurred in IPTA are financed by government grants whereas 6%

comes from student fees. One of the main objectives of the study is to identify the basis in setting the education fees of IPTA.

One of the methods use to conduct the research was by assessing the 1997 and 1998 annual report of the universities. An analysis of comparison between fees charged in IPTA and IPTS was made to highlight the competitiveness of the universities and also to give a clear picture of the financial management of the IPTA. One of the key findings of the study was to recommend that financial information should be managed in proper way in order to reflect the actual spending of the universities.

Mohamad Rosni and Mahamad Tayib (2001) focused on the area of budgeting in public universities and suggested that Malaysian public universities do to some extent adopt the so-called 'good- budgeting' characteristics.

Another study is currently undergoing and 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 by comparing the different programs or courses offered by IPTA and IPTS.

There is no prior study known to author that examine the quality of disclosure of the external reporting of public universities. However studies as presented had shown the efficiency and effectiveness of the universities is the main issue. Both criteria would determine things such as the fees charging and competitiveness of the programs offered by universities as well as the cost per student. The fact that public universities are adopting the good budgeting system indicates that they have good financial management. Thus in order for public, especially, to be informed of this situation this must be disclosed in universities' annual reports.

Issue of efficiency and effectiveness are closely related to accountability. "Accountability involves rendering some form of account that activity is being carried out effectively and efficiently"(Williams and Loder, 1986, page 2). In this sense annual report would play the role of discharging accountability.

Therefore in this context, it is felt that Malaysian universities' annual report should be examined to assess the extent of its accountability information.

Additionally, another issue relating to the annual reports that worth to be examined is the extent of the existing disclosure information satisfies the current users' of such reports.

2.4 CONCLUSION

This chapter provides an overview of related and relevant accounting literature in examining the disclosures of external reporting of the universities and identification of the use and uses of universities' annual reports. This chapter also identifies the gaps in the reviewed literature. Chapter Three outlines and justifies the methodological framework.