PUBLIC FINANCE REFORM IN MALAYSIA: ISSUES AND CHALLENGES

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Abstract - The objective of this paper is to address briefly governments’ efforts on economic transformation and some of the changes of systems through public finance reform policy. The public finance reform initiatives are believed will strengthen country’s financial position and reduce government’s debt to cushion the economy against external shock. Some of the vital initiatives under public finance reform are accrual accounting system and good and service tax (GST). Therefore, this paper will discuss and dispute the implementation of the accrual accounting system in the public sector and elaborate the issues and challenges pertaining to the changes of taxation system.

Keywords: Accrual Accounting, Good and Services Tax, Public Finance Reform

1. Introduction

In 1981, Malaysian public sector reform started. But, only in 2010, the journey of a developing country, Malaysia to become fully developed nation and high income economy has begun. The development path needs structural reform and change in mind set of its citizen to achieve Vision 2020.

On 5 July 2011, Malaysian Government has announced six (6) Strategic Reform Initiatives (SRIs), which is the second critical component of Economic Transformation Programme (ETP) to boost and strengthen Malaysia’s global competitiveness. Strategic Reform Initiatives is made up of supportive policies and public finance reform is one of their initiatives.

The Public Finance Reform Strategic Reform Initiative (SRI) is targeted at strengthening the Government’s finance to ensure stable and sustainable of public funds. Through this SRI, it supports Government’s goal to reduce its budget deficit to around 3% by 2015 and near budget neutral by 2020, which are also the objectives identified by the National Economic Advisory Council (NEAC) in the New Economic Model (NEM).

The aim of Public Finance Reform is to increase the Government’s revenue while carefully managing expenditure. Through that, Malaysia has recorded the decline in the budget deficit to
3.5% of GDP in 2014, with federal debt projected to come in at 54.7% of GDP which continue to be below the Government’s debt ceiling of 55% (http://etp.pemandu.gov.my).

Specifically, the Public Finance Reform Lab had proposed a list of 21 initiatives supplemented with 2 individual initiatives – enabler accrual accounting system and replacing sales and service taxation system with introduction of broad-based tax (GST). The key policy measures under Public Finance Reform such as improve tax compliance and administration, rationalisation of corporate tax incentives, expenditure control, transparent procurement and other initiatives (broad-based tax and accrual accounting).

The list of the initiatives implemented from 2011 and to be carried out onward is as follows:

**List of Initiatives**

| A. Improve Tax Compliance and Administration | 1. | Widen Field Audit and Investigation Coverage |
| | 2. | Widen the Tax Base |
| | 3. | Improving Efficiency in Tax Submission and Tax Collection |
| | 4. | Revise depreciation rate of gazetted value of imported used cars |
| | 5. | Audit-based control on exporters and importers of liquor and cigarette |
| | 6. | and Free Commercial Zone |
| | 7. | Enhanced Customs’ enforcement/audit |
| B. Rationalisation of Corporate Tax Incentives | 7. | ‘Step-down’ (From Full to Partial) Exemption for Shipping Income |
| | 8. | Review incentives in Promotion of Investments Act 1986 |
| | 9. | Review Single Deduction, Further Deduction, Double Deduction |
| | 10. | Step-down’ of Reinvestment Allowances |
| C. Expenditure Control | 11. | Increase cess for rubber replanting |
| | 12. | Cost effective funding mechanism (for public funded universities) |
| | 13. | Optimise asset utilisation (for public funded universities) |
| | 14. | Reduce Govt. travelling expenses by 15% |
| D. Transparent Procurement | 15. | Widen E-bidding scope - reducing threshold value from RM200k to RM50k |
| | 16. | procurement of good & services |
| | 17. | Enforce Procurement Plan |
| | 18. | Eliminate Incompetent Suppliers/Service Providers |
| | 19. | Capacity Building (Certified training course for procurement officers) |
| | 20. | Value Management (VM) |
| E. Other Initiatives | 20. | Broad-Based Tax (GST) |
| | 21. | Accrual Accounting |

Figure 1.1: List of Initiatives under Public Finance Reform Programme
(Source: ETP, 2013)

This research is a revision of previous studies in regard of the public finance reform in Malaysia. Nonetheless, the purposes of this paper are to discuss only two sub areas namely accrual accounting and broad based tax for two reasons. First, both of these two systems are considered as new systems in Malaysia. Second, the impact from the employment of these two systems is
considerably extensive to most of the users. Therefore, a collection of literatures were reviewed and analysed, as a result, several keys issues regarding the research subjects were identified and summarized. The key issues will be divided into two parts. First part will be concentrated in discussing the issues and challenges faced in implementing accrual based accounting. Second part will be elaborating the implementation of broad based tax (GST) and the reason why GST should replace the Sales and Service Tax (SST).

2. The Implementation of Accrual Accounting

For the past two decades, world have seen greater demands for accountability in public sector whereby there are significant increasing numbers of governments around the globe employing accrual accounting for financial reporting and budgeting purposes (champoux, 2006). Accrual accounting has been argued to be favourable for the governments since it can provide more information for decision makers (conolly and hyndman, 2010) and enhances efficiency, effectiveness, transparency and accountability (monteiro and gomes, 2013).

Traditionally, cash accounting is being used by many governments throughout the world (van der hoek, 2005). However, some of the limitations 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, dale, eggers & sacco, 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). Accrual accounting on the other hand provides information which helps to provide a better overview of the government’s financial activities and financial position (nesbakk, 2011).

Gomes (2013) highlighted that accrual-based accounting has lots benefits especially it has a greater transparency through more comprehensive information on the use of resources and status of liabilities. She also argued that accrual accounting leads to increase accountability and credibility, improve financial management, harmonisation of financial reports and statements across public institutions as well. Accrual based accounting may also improve government reporting, the understanding of balance sheet and how the resources are managed.

2.1 Accrual-based Accounting in Malaysia

As of 1 January 2015, Federal Government of Malaysia set to adopt full accrual-based accounting for financial reporting, which is in line with the requirements of the International Public Sector Accounting Standards (IPSAS) through the introduction of public finance reform. The implementation of accrual-based accounting in Malaysia will led to major changes in public finance management with regards to strategy, process and structure. Initially, Malaysian Federal Government adopted cash basis IPSASs in 2005. While in 2011, the announcement of adoption of accrual accounting by the government has been declared. In March 2013, the Treasury explained the roles and responsibilities of financial controlling officers to implement accrual accounting by issuing Circular No. 4 Year 2013. Moreover, to assure the smoothness of the new accounting system, the Accountant General was appointed as a “Change
Ambassador” to drive the transformation towards accrual-based accounting. In May 2013, the change of Management Plan was released to make sure that the parties involved fully understand the new system and offer full commitment to the implementation of accrual accounting. Furthermore, for the preparation of the implementation in all ministries and agencies, data collection of the opening balances of assets and liabilities started in April 2013. The data collection has been executed until December 2014.

The blueprint for accrual-based accounting of Government Financial Management Accounting System (GFMAS) development is ongoing, with the approved design of the functional system in October 2013. To date, Government Accounting Standards Advisory Committee had approved 20 Malaysia Public Sector Accounting Standards (MPSAS), while 11 MPSAS were approved by Accrual Accounting Steering Committee. The Accrual Accounting Steering Committee has approved new accrual-based accounting policies drafted for the development of the new accrual-based accounting system scheduled for implementation in 2016.

2.2 The Reason behind the Changes

Since independence, federal government has been using cash based accounting. Thus, the change to accrual-based accounting is a vital decision for Malaysia to be at par with developed countries as a result of the government expansion in activities and limited economic resources (Ruhaya Atan, 2015). Based on Malaysian Institute of Accountants (MIA), the shift from cash-based accounting to accrual accounting will enable the public sector to report its actual financial position and financial performance, cash flow more accurate towards enhancement of transparency and accountability in its financial management. The move is not only good for fiscal discipline and governance, it will also assist government efforts to become a high-income nation and developed country status by 2020.

On top of that, it can be an effective measurement for policy outcomes. The change to accrual accounting in Malaysian public sector also means there will be a higher demand of qualified accountants in Malaysia and the enhancement of competencies of accountants.

2.3 The Way How the Changes Takes Place

Gomes (2013) stated that the new accounting system of GFMAS can maintain two ledgers, the cash ledger and accrual ledger to keep track on both accrual and cash transactions. On the other hand, she stated that IPSAS enabled international aid agencies to account for donations received from worldwide more accurately and transparently if compared to cash-based accounting. Besides that, all assets have to be showed and recorded accurately. There is also a need to be comparable with the accounts of other agencies, internally or within the organisation’s different divisions and wherever they may be.

Under the cash basis accounting, revenues will be reported on income statement only in the period when the money is received from customers. While, expenses are reported on income statement when money is paid. On the other hand, through accrual accounting, revenues are reported on income statement when they are earned even if it occurs before cash received from the customers. While, the expenses are reported on income statement when they occur, expire, even if it is in different period from when the payment is made or before payment is made.
The accrual accounting gives a better image of organisation’s profits as the income statement prepared under accrual basis will report all of the revenues actually earned and all of the expenses incurred to earn revenues. It also provides a better image of a company's financial position at a point of time because all assets earned are reported and all liabilities incurred will be reported as well. It is crucial to determine full cost of government activities systematically. Hence, this is the justification why accrual accounting is very commonly used in businesses as well.

3. **Broad-based Tax of Goods and Services Tax (GST)**

On 25 October 2013, Prime Minister of Malaysia proposed the introduction of Goods and Services Tax (GST) to replace the current Sales and Service Tax (SST) during the Budget 2014. The implementation of the GST has effective on 1 April 2015, at a rate of 6%. In many countries, GST also known as value added tax (VAT), whereby, it is a multi–stage consumption tax on goods and services. GST is a broad-based tax covering all sectors in the economy which is imposed from production of raw input (supplier) to the sale of the end product (retail stage) at each stage of supply chain. However, the tax is not part of the cost of the product even though GST is imposed at each stage of the supply chain, because GST paid on the business inputs is claimable. Any person who makes a taxable supply for business purposes and taxable turnover exceeds the threshold of RM500,000 is required to register his/her business for GST. Nevertheless, business with taxable turnover of RM500,000 and below is not required to register for GST, but they may choose to apply for voluntary registration (www.custom.gov.my).

The implementation of the GST is expected to improve the transparency, efficiency and effectiveness of Malaysia’s taxation regime as the current SST has a lot of weaknesses. It is also a business-friendly taxation system as it enabled business to reduce their costs by allowing them to claim for GST charged on their business.

On the other hand, consumers will get benefit as well because most of basic essential products and services such as rice, vegetables, raw meat, cooking oil, fresh fish, domestic public transportation and healthcare services are not subjected to GST, which means they are tax exempt (zero-rated). This shows that the implementation of GST do concern on the needs of the low and middle income household. This GST has been charged on the supply of Malaysian-made and imported goods and services. The new system might be a slightly higher tax burden on consumers, but it depends on the consumers’ consumption patterns.
The main issue of GST is the public acceptance of the system, as most Malaysian still do not understand GST (Zhou et al., 2013). Apparently, they concern on whether the prices of goods and services will rise or not after the implementation of GST. In order to improve their understanding and public awareness on GST, the government has taken some efforts by organising continuous awareness programmes such as public consultations and seminars for consumers, increasing publicity of the GST through mainstream media (television networks, newspaper, radio etc.), upload information for consumers on the GST Portal http://www.gst.com.my/, conduct roadshows at public (schools, shopping complex) and collaborate with non-government organisations, consumer association, and schools to educate consumers. The government will continue engaging with the public sector, business community and citizens to make sure that GST will be accepted by public and can be implemented smoothly.

Moreover, the government will enforce strict action to make sure traders will not use the GST as a reason to raise prices unnecessarily. Thus, the government has enforced the Price Control and Anti-Profititeering Act 2011. Shopper’s Guide has been published by the government and supermarkets will be the point of benchmark pricing programme. Prices will also be monitored by The National Price Council from time to time. Traders that do not follow the regulations will be charged with heavy fines and penalties.

GST also helps to correct the imbalance of dependence on direct tax revenue compared with indirect tax revenue and also the dependence on oil revenue. Besides that, GST will overcome weaknesses of the SST such as tax cascading and tax compounding where SST is cost to businesses as they are not claimable. By implementing GST, Malaysia will follow the footsteps of 160 countries which have introduced the new regime. 6% rate of GST that has been imposed by the government is among the lowest in the world and less than the seven ASEAN countries-Indonesia, Thailand, Singapore, Philippines, Cambodia, Vietnam and Laos which have already implemented GST system.
3.1 The Reason for the GST Implementation

GST is a fairer and better tax system if compared to SST (Sales & Service Tax). Firstly, the reason on why government choose GST over other high taxes because it lowers business cost. Under the current SST system, some business had to pay multiple taxes and high level of tax-on-tax. Through GST, businesses can recover the input tax on raw materials and expenses as for manufacturer, retailer, wholesaler, GST is claimable, and therefore it will reduce costs. Secondly, it increases global competitiveness. As no GST is imposed on exported goods and services, prices of Malaysia exports will become more competitive globally. This will not only strengthen our export industry, it will help Malaysia progress even further. Thirdly, taxes are divided fairly among all the business, no matter they are in the manufacturing, wholesale, or service sectors. Fourthly, GST will provide a fair price to consumers. GST eliminates double taxation which happens under SST. Thus, for most of goods and services, consumers will pay fairer prices compared to SST. Finally, GST system has a better transparency. Unlike the present SST, consumers will know whether the goods they consume are subjected to tax and also the amount they pay for.

3.2 Improving Tax Compliance and Administration

GST has been disputed to improve tax compliance among taxpayers. In general, tax revenue will be increased as GST can bring about greater compliance, thus increasing the number of taxpayers and tax revenues for the government.

One of the main advantages of GST system is that it provides an incentive for businesses to comply with. This is because it is a multi-stage tax which means that they are able to claim offsets against GST paid on inputs which will bring them into the tax collection net. This widens the scope of coverage and increases the number of goods and services that are taxed. Another point is that with higher compliance, there should be less tax evasion which will in turn ease the growing budget deficit and strengthen fiscal management of the Malaysian economy.

The Royal Malaysian Customs Department (RMCD) has been tasked to improve tax compliance and administration. Thus, the RMCD will continue to implement initiatives to improve indirect tax collection such as audit-based control on exporters and importers of liquor and cigarettes in duty-free islands and Free Commercial Zones and enhanced customs enforcement or audit. In 2013, RMCD had surpassed its collection target of RM100 million with collection of RM125.02 million. Nevertheless, the Department faces legislative issues in implementing audit-based control on exporters and importers of liquor and cigarettes in duty-free islands and Free Commercial Zones. The enhanced enforcements which RMCD decided to focus on include informing businesses of new audit requirements, increasing audit coverage on registered licensees and importers by reviewing audit targets and enhancing the competency of audit officers through capacity-building and improving audit mechanisms.
The effects of the initiatives under the Improving Tax Compliance and Administration programme remains encouraging and contribute to the increase in revenue collection. Since its implementation in 2011, tax collection for direct tax shows a continuous growth. In 2013, total direct taxes collected increase to RM127.02 billion from RM116.94 billion in 2012. For indirect tax, in 2013, the total tax collection has increased to RM36.49 billion from RM34.71 billion in 2012. Direct tax includes petroleum income tax (PITA), from companies and individual tax as well, while indirect tax consists of excise duties, GST, sales tax and service tax.

3.3 Recommendations in Achieving Fiscal Sustainability

According to Zhou, Tam, & Heng-Contaxis (2013), in order to achieve fiscal sustainability, the implementation of GST should be incorporated into a wider objective. They come out with few recommendations as follows:

3.3.1 Raise awareness on exemption list and stop expanding the list. Awareness on exempted items should be raised through effective communication. Consumers should also be educated on what to do should they fall victim to price manipulation.

3.3.2 Enforce display of GST charges on price tag. All items that are chargeable by GST should display the actual amount of tax payable on the price tag. Items that are exempted from GST should also carry price tags that describe the corresponding tax category.

3.3.3 A one-off cash assistance worth RM500 should be given to households earning less than RM3,000 (40% of total households) and it should be in the form of voucher rather than direct cash handouts. This cash assistance worth RM500 is sufficient to help the most vulnerable households smooth out sudden changes due to the introduction of the GST. This assistance should only be given out to households earning less than RM3,000, because they are not eligible to pay personal income tax.
3.3.4 Strengthen cooperation with local consumer society to fight profiteering activities. Individual consumers who are the victim of profiteering activities are less likely to take action against irresponsible traders. The government should promote the establishment of a local consumer association to increase the effectiveness in gathering reports of price abuse and strengthening the capacity of enforcement agencies to carry out their duties.

3.3.5 Commit to a 5-year timeline and review GST with the possibility of raising the rate by 2020. The government should restrict itself from arbitrarily increasing the GST rate within the 5-year period. This allows for price stability and better consumption planning. Committing to a time schedule with a review of the GST at the end of the 5-year period increases the credibility of the government to enforce its deficit-reduction plan.

3.3.6 Enhance communication on the importance of reducing the budget deficit to raise public acceptance of the issue. Issues like leakages and a lack of transparency in public expenditure should be resolved more vigorously in order to build credibility in the government’s fiscal adjustment plans. In a meantime, the government should invest revenue gains in improving the quality of public health services, public transportation and promoting equal access to education to improve productivity.

On top of that, a good example for Malaysia is to follow a well-established GST implementer such as Singapore, which has been successful in its GST implementation since 1994 (Zainol, Faridahwati & Zainuddin, 2014). According to Lee (2011), some of the critical factors for successful GST implementation in Singapore are strong commitment from the government, well-designed implementation timetable and well drafted laws, close cooperation between the different authorities involved, a comprehensive public education campaign, strict enforcement, and an effective GST audit programme.

4. Conclusion

In a nutshell, the public finance reform initiatives will strengthen country’s financial position and reduce government’s debt to cushion the economy against external shock. The Federal government continues their efforts to achieve balanced budget by 2020. In order to materialize the nation goal to become a high income nation by 2020, many efforts have been planned and executed by the governments. This includes 21 initiatives supplemented with 2 individual initiatives – enabler accrual accounting system and replacing the sales and service taxation system with introduction of broad-based tax (GST).

Not all countries using cash based accounting have done badly, and not all countries using accrual accounting had done well. Germany still uses cash-based accounting and they success. Thus, 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 (Rozaidy et.al, 2014)

Same goes to GST, if the government intends to expand the tax base and increase the efficiency of tax collection through the use of GST, it will bring the majority of the population within the tax base (Zhou et al., 2013). Therefore, all citizens become stakeholders in the budget and the
government must begin to display strong political will to cut wastages, leakages and corruption. Prudent spending and transparent accounting will go a long way in winning over public acceptance of the GST.

References


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