VARIABLES UNDERLYING THE GOVERNMENT’S
ACCOUNTING REFORM IN MALTA

BY
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ABSTRACT

The process to reform the Malta Government accounting system was formally initiated way back in 1999. Fifteen years has passed since then and for some impressive reason this process is not yet finalized and is still ongoing. Almost all the preparatory work for the transition has been conducted. Only the issuing of the tender to replace the current cash accounting software remains to be done. This study undergoes an empirical analysis of the main obstacles obscuring such transition. A total of 11 semi-structured interviews were conducted to analyse the views and intentions of the people heading the accounting reform in the Maltese Public Sector. The findings indicate that the introduction of accrual accounting at the central level of Malta is continually being delayed because the present statistical reporting requirements for Eurostat are being achieved with the current patched-up cash-based accounting system. As a result, the priority, motivation and interest for an accounting reform at Malta’s central government are being lost. This assertion reflects the lack of commitment shown by the top political actors and the senior bureaucrats that are involved in the Maltese accounting reform. In fact, the politicians and the high level administrative officials continuously project themselves as if they are committed to act, even though they have no intention to do so or have no idea what the requirements of the reform entail. This explains why the introduction of accrual accounting is often given prominence in the annual Budget Speeches and yet nothing transpires.
DECLARATION

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I hereby declare that I am the legitimate author of this Long Essay/Dissertation/Thesis and that it is my original work.

No portion of this work has been submitted in support of an application for another degree or qualification of this or any other university or institution of learning.

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Signature of Student

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28/05/2014
Date
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<td>ACCA</td>
<td>Association of Chartered Certified Accountants</td>
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<td>AATF</td>
<td>Accruals Accounting Task Force</td>
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<td>BPM</td>
<td>Balance of Payment System</td>
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<td>CPA</td>
<td>Certified Public Accountant</td>
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<td>DAS</td>
<td>Departmental Accounting System</td>
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<td>ESA</td>
<td>European System of National Accounts</td>
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<td>EU</td>
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<td>GFS</td>
<td>Government Finance Statistics</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IPSASB</td>
<td>International Public Sector Accounting Standards Board</td>
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<td>IPSASs</td>
<td>International Public Sector Accounting Standards</td>
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<td>MFS</td>
<td>Monetary &amp; Financial Statements</td>
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<td>MGASs</td>
<td>Malta Government Accounting Standards</td>
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<td>NAO</td>
<td>National Audit Office</td>
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<td>NPM</td>
<td>New Public Management</td>
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<tr>
<td>NSO</td>
<td>National Statistic Office</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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CHAPTER 1

INTRODUCTION

Accounting is an information system expressed in money terms. It is best defined as ‘the process of identifying, measuring and communicating financial information about an entity to permit informed judgments and decisions by users of the information’ (Basic Accounting Theory Committee Staff 1966, p. 1).

There are two bases of accounting by which financial information could be prepared and presented, namely the cash basis and the accrual basis. The difference between these two methods has to do with the timing in which transactions and other events are recognized in the books of accounts.

In cash based accounting, income and expenses are recognized and recorded when funds are received or disbursed. On the other hand, in accrual based accounting, income or expenses are recognized and recorded at the time and during the period of performance and delivery, even if no cash inflows or outflows are incurred.
1.1 The Maltese Public Sector Accounting System

Presently, Malta’s central government financial reports are based on the cash method of accounting, whilst the local government, public corporations, authorities, entities, agencies and parastatal organizations issue private sector style financial statements.

For the past couple of years, the central government of Malta has embarked on a process to reform the current central government accounting system. The aim of this reform is to move from the traditional cash-based accounting system to the accrual-based system.

1.2 Accounting Reform at Malta Central Government

This sub-section provides a historical account of the main events related to the accounting reform in Malta.

In 1998, during a seminar on effective government management systems, Dr Alfred Sant, the prime minister of Malta at that time, said that it was high time that a modern and a more informative accounting system would be adopted for all government financial statements and budgets (Sant 1998).

An Accrual Accounting Task Force (AATF) was set up in 1999 to plan and coordinate the implementation of the new accounting methodology. The members of this task force
included representatives from the Treasury Department, Internal Audit and Investigations Department (IAID), Major Ministries, Malta Information Technology Agency (MITA), Malta Institute of Accountants (MIA) and the National Audit Office (NAO) (as observers).

The Malta Government Accounting Standards (MGASs), which were based on the International Accounting Standards (IASs), had concurrently been drafted. Eventually, these (the MGASs) were superseded, and now the official accounting standards for the government of Malta are the International Public Sector Accounting Standards (IPSASs).

Various circulars on accrual accounting were from time to time issued by the Ministry of Finance and the Treasury Department. Extensive training programmes have also been provided to staff within the ministries and departments. In turn, since 2002, the ministries and departments have been providing trial ‘modified accrual-based financial statements’ on a quarterly basis. These are being drawn up by collecting accrual data and integrate it with the cash-based data from the Departmental Accounting System (DAS), the accounting software. The collected accrual data relate to fixed assets, inventories, accounts receivables, prepayments, deferred income, accounts payables, accruals and other credit transactions. These (modified accrual-based financial statements) are not published, and are only used for internal purposes. Yet, these are often used to answer parliamentary questions, such as questions on the amount of account receivables/payables.
An Accounting Methodology and Compliance Unit was also set up in 2004 within the Treasury Department. This unit is responsible to assist and ensure that each and every ministry and government department is adhering to the circulars issued on accrual accounting. The main objective is ‘to obtain a true and fair picture of the financial situation of each Department when compiling the yearly financial statements under the accrual accounting methodology’ (Treasury Department n.d.).

In addition, the Management Efficiency Unit (MEU) is being instrumental in solving any difficulties that occur during the transitory period.

1.3 Need for the Study

The process to reform the Maltese accounting system was formally initiated way back in 1999. Fifteen years has passed since then and for some impressive reason this process is not yet finalized and is still ongoing.

The accrual accounting reform is from time to time mentioned in the annual Budget Speeches. It has had been assigned different timeframes for its completion, none of which have been met.

Almost all the preparatory work for the transition has been conducted. Only the issuing of the tender to replace the current cash accounting software remains to be done.
The aim of this study is to analyse the main obstacles obscuring such transition. All accounting stakeholders seem to be in favour of the accrual accounting reform. There also appears to be a consensus between the two major political parties. So, why are different administrations reluctant to implement such policy? Why are the authorities constantly postponing the actual reform? Is this an example of a policy suffering from inertia, bureaucracy or a lack of political willingness and interest in reforming the public accounting system?

1.4 Research Aim and Objectives

The aim of this study is to analyse the reasons why the road to the accounting reform in Malta has been so long-winded.

The objectives of this study are:

- Firstly, to identify the primary changes that are required for the restructuring of the Maltese Government accounting system.
- Secondly, to analyse whether or not the change to accrual accounting enhances governance, transparency and accountability, and whether it better meets the users' information needs.
- Thirdly, to examine the reason/s why such a long-winded transition seems so difficult to implement.
- Fourthly, to establish whether it is still crucial for Malta to shift to accrual accounting, considering that such transition involves a substantial cost of implementation, and that the anticipated benefits would take longer to achieve.

- Finally, to make recommendations which are deemed to be relevant to the implementation of accrual accounting after considering the above objectives.

1.5 Limitations of Scope

There are certain limitations to this study. First of all, the main perspective of this research is that of civil servants and other elites, rather than that of politicians. This has been decided in an attempt to avoid political bias and partisan politics.

In addition, I am focusing on what has happened till 2013.

1.6 Dissertation Overview

This dissertation is divided into five chapters.

As an introductory chapter, Chapter 1 provides a general overview of the topic. It also outlines the need of the study as well as the aims and objectives to be reached.
Chapter 2 provides the reader with a literary review on the main points that distinguish cash from accrual accounting and government financial reporting from the business financial reporting. It also describes the manner in which government financial statistics are compiled by international institutions.

Chapter 3 describes the research methodology adopted for the purpose of collecting sufficient data to evaluate the variables underlying the Government's accounting reform in Malta.

Chapter 4 presents the findings of this study and a thorough analysis of such findings.

Chapter 5 summarises the study and presents recommendations derived from the research.
CHAPTER 2

LITERATURE REVIEW

This chapter aims to link the literature review with research objectives identified in Chapter one. The main points that distinguish the public sector from the private sector are highlighted and a brief overview on the main developments that have occurred in government financial reporting structure throughout the last years, particularly with the notion of New Public Management, is given. Ultimately, the characteristics of the Maltese public sector and the Maltese Government accounting system are explained, and details are given on the way the Maltese Government records and controls public spending.

2.1 Cash versus Accrual Accounting

The cash method of accounting is the simplest form of accounting. Up until the 16th century, it was the only accounting system used by both the public and the private sector (Babatunde 2013). However, as markets developed and capital formation was
facilitated, the principal and the agent were no longer one and the same. This led the private sector to start adhering to a set of accounting standards, based on the accrual accounting methodology.

The methodology of cash-based accounting is very straightforward and no financial expertise is required to apply, understand and interpret it. Fewer transactions are recognized in cash accounting, and thus it is less time consuming and inexpensive for organisations to comply with it.

Yet, the accrual accounting approach is deemed to provide more reliable financial information rather than information based solely on cash receipts and payments occurring during a reporting period. One of the main benefits is that it yields an income figure and a capital measurement (Jones and Pendlebury 2010).

In addition, such approach is consistent with the accounting principle of matching. The matching principle ensures that costs that generated particular revenues are coordinated with them. In this manner, the efficiency with which a particular product’s cost is converted into revenue (or the surplus we call profit) can be assessed (Ryan 1995).

The accrual method of accounting makes it also more difficult for one to postpone or to bring forward cash receipts and payments. Thus, information produced under its methodology is more faithful than its alternative.
For these reasons, most jurisdictions and accounting standards boards suggest that private entities should prepare their financial statements using the accrual basis of accounting.

### 2.2 Public Sector versus Private Sector

A government organization is fundamentally different from a business organization as it operates in a political environment and its objective is not to maximize income or profit.

The public sector is responsible for the organization of government programmes and policies, and the behaviour of the officials who are responsible for this conduct. It analyses and implements public policies, from which people could benefit; delivers public goods and services to the community as a whole, and redistribute resources by means of subsidies, grants and other similar transfers. The government is also responsible for certain types of assets that are only found in this sector, such as the military, heritage and infrastructural assets (Tiron Tudor and Mutiu 1990).

Government’s expenditure on the public service in many countries amounts to more than one-third of Gross Domestic Product (Fawcett 2013). The majority of this expenditure is funded by taxes, and this is one of the reasons why the Public Service and other employees in the public sector ought to be of the highest integrity, accountability, fair and efficient.
2.3 New Public Management

New Public Management (NPM) is ‘the theory of the most recent paradigm change in how the public sector is to be governed’ (Lane 2000, p.3). It was first implemented in the UK under Prime Minister Margaret Thatcher and the US under President Ronald Reagan (Gruening 2001). In order to get control of costs, Prime Minister Thatcher, President Reagan and other OECD countries began to look at the principles of the private sector and saw how these principles could be incorporated in the public sector. One of the main principles of private sector companies is to maximize gains by controlling costs and receive the highest return on investments.

NPM puts the manager at the centre of the public service, with the latter’s performance being gauged by the ability to generate output and outcomes. One of the most important factors is to let managers manage, which means that politicians should not get involved much in what managers do. Hence, while retaining the values of the public sector, managers would adopt managerial techniques of the private sector in the public sector, which ultimately will increase the latter’s performance (Hughes 2003).

2.3.1 Objectives and Users of Government Financial Statements

According to Chan (2008), government accounting serves three purposes, namely to protect the public treasure by identifying and averting extortion and bribery, to simplify sound financial management and to assist government acquit its public accountability.
In addition, Wynne (2003) states that

the defining class of user of financial statements in the public sector should be the electorate. Their elected representatives act on their behalf and use the financial statements to hold the government and civil service to account for the resources which they were allocated to provide the agreed level of goods and services.

Schumesch (as cited in PwC Global Survey on Accounting and Reporting by Central Governments [PwC Global Survey] 2013) goes a step further by saying that the state is the greatest organization in every country. He argues that precisely as the plank of directors of a private company is accountable to shareholders, governments should be accountable to parliament and citizens.

Government financial reports are also prepared to offer a foundation for assessing the current financial status and past performance for decision-making purposes (PwC Global Survey 2013). They satisfy the financial needs of investors and financial markets, creditors and suppliers, donors, economists, lenders, the media, civil servants and the general public at large.

2.3.2 Public Sector Accounting and New Public Management

Historically, government financial accounting followed the cash-based system of accounting. It includes providing a production report comparing the actual settlements and receipts with those that were passed in the budget by Parliament (Wynne 2004).

Though simple, under NPM this system of budget-oriented accounting is constantly being criticized for its inability to provide accurate and accessible financial information
that could be used by a wide range of users for appropriate decision-making needs and conclusions. According to Radermacher (2013), Chief Statistician of the EU, it is arduous to apprehend why after five hundred years (since the first version of double-entry bookkeeping was published in 1494) we are not using double-entry bookkeeping in the public sector.

The majority of countries that have embraced the NPM techniques have introduced the accrual basis of accounting (Connolly and Hyndman 2010). In fact, Groot and Budding (2008) state that a crucial aspect of NPM is the idea to replace traditional cash accounting rules for financial reporting functions. Likewise, Likierman (as cited in Connolly and Hyndman 2010) points out that without the diligence of the accruals accounting model some of the NPM adjustments would be depleted.

The changeover to accounting standards as in the commercial sector allows also for correlation with possible private sector suppliers of public services and ultimately leads to the harmonization of the global accounting standards for both sectors.

The transition to a private sector-style financial statements system in central governments is thus instigated as part of a reform to improve economy, efficiency and effectiveness of government operations. The ultimate aim is that once the business accrual accounting standards are adopted, accounting in the public sector would be used as a management tool across the board.
2.4 The Primary Changes which result from the transition to Accrual Accounting

Public sectors that adhere to the cash based accounting system are often accused of a lack of financial planning and of not being accountable and transparent on how monies out of the public purse are spent.

Indeed, the cash accounting method includes major deficiencies in government systems, namely a poor definition of the goals and performances of each ministerial and departmental organisation; an improper maintenance and a poor measure of depreciation of physical assets, including significant infrastructure assets; a misrepresentation and an omission of long-term liabilities and losses; and a slow responsiveness and adaptation to changing circumstances, especially in view of an increased global competitive pressure that requires efficiency for survival and which are often ignored in budget-oriented accounting systems.

However, the fundamental shortage of the cash based system is its short-sightedness, which enables governments to conceal the real state of their finances, and thus passing off current costs to prospective progenies (Ball et al. 1999).

2.4.1 Main Advantages of Public Sector Accrual Accounting

Camilleri (2006) indicates that the governments’ decision to propose ‘modern financial methods’ for the public sector derives from the aspiration to develop more relevant
financial information that will devote to a fuller understanding of the overall financial health of Government, thereby offering a foundation for practical long term financial projections and planning.

Having a long-term financial perspective is extremely important for governments as governments’ strategies, roadmaps and policies are set out on a long run basis. Political leaders need to see the current stance of government funds to understand the government’s financial capacity before making commitments for new programmes and service (PwC Global Survey 2013).

Unfortunately, the cash method of accounting focuses on short term perspectives, usually for a time period of one year only. Hence, such an accounting method does not fit for proper strategic planning purposes of governments.

Moreover, cash accounting does not grant users to ‘assess the accountability for all resources the entity controls and the deployment of those resources’ (IFAC Public Sector Committee 2002, p. 7). The accountability of managers/administrators extends with the introduction of accrual based accounting, as these would require specifying clearly their execution in service provision vis-à-vis full resource cost of rendering the service (Diamond 2002). In turn, transparency would also be expected to increase, as the public officials would be less sheltered from public scrutiny.
2.5 Issues currently faced by developed countries

The recent Great Financial Recession and the subsequent sovereign debt crisis have had a substantial effect on public sectors around the world, especially on those in the OECD. In an effort to cope with stagnant economies and significant debt, governments and public corporations in developed countries have had to suffer from restricted budget cuts and severe sturdy austerity measures. In some countries government’s debt exceeded even its GDP.

Governments around the world are concurrently facing a number of complex challenges, namely maturing societies, soaring health care costs, renovation of welfare support, supply of quality education, the environment and change in atmospheric conditions, defence costs, preservation of natural resources, terrorism, crime and infrastructure costs (the Association of Chartered Certified Accountants [ACCA] 2013).

It is also a time where public trust and the perception of the public services are falling dramatically. The Edelman trust barometer, a public option temperature test of more than 31,000 individuals from around the world, shows that people are trusting businesses more than governments (Edelman 2014). In addition, the Eurobarometer surveys confirm that faith in EU institutions is at all-time low (European Commission 2013a). According to Quinn, a director with the World Bank, investors are no longer confident that what governments tell them about their finances is complete and accurate (Quinn as cited in PwC Global Survey 2013).
These circumstances are creating a lot of pressure on governments to improve the management of the resources entrusted to them and to publish top-quality financial information. Greater transparency is also an exclusive requirement to increase confidence of stakeholders.

A report commissioned in 2013 by PricewaterhouseCoopers, one of the Big four audit firms, states that better accounting leads to better reporting, which provides the information necessary for better decision-making, which in turn should lead to better use of public resources (PwC Global Survey 2013).

On the other hand, Sanderson and Van Schaik (2009) point out that the need for accountability in the public sector and for transparency in its financial dealings becomes greater at this fourth dimension of the crisis. Citizens want to know how the excessive sum of capital exhausted in response to the financial crisis will influence the financial management of their governments.

The long-term financial impacts of a political decision are only given consideration if the financial statements are prepared under the business accounting model. Such considerations ensure stability in the markets by increasing the calibre and reliability of, and confidence in, governments’ financial statements and help restore confidence in their power to handle their financial balances (PwC Global Survey 2013).
2.6 Public Sector Accounting Standards

Private entities around the world are usually required, by statute law, to account in compliance with International Financial Reporting Standards (IFRSs), (formerly known as International Accounting Standards (IASs)). These standards are issued by the International Accounting Standards Board (IASB) and are accrued based.

Since public sectors are fundamentally diverse from private sectors, it is naturally impossible to ingrain IASs in totality into public sector accounting rules and expect them to work (Gingell 2003).

Many countries have, for this reason, developed their own accounting standards for their public sector based on IFRSs. A case in point was when in 2001 the Maltese Government issued the Malta Government Accounting Standards (MGASs) to be used in the Maltese public sector.

Moreover, since 1997, a set of international public accounting standards has been developed. These standards are known as the International Public Sector Accounting Standards (IPSAS) and are developed by the International Public Sector Accounting Standards Board (IPSASB), a standard-setting board within the International Federation of Accountants (IFAC).

IPSASs are based on IFRSs and thus follow the accrual method. They aim to
enhance the quality and transparency of public sector financial reporting by providing comprehensive information for public sector financial management and decision-making (International Federation of Accountants n.d.).

Eventually, they work towards harmonizing public sector accounting across the world.

2.6.1 A Clear Trend towards the adoption of Accrual Accounting

Chile was the first country that, in 1973, introduced the private sector style financial statements for its central government. It was followed by New Zealand, the USA, Australia, UK and Canada amongst others.

The number of countries that are now adhering to the business-like accrual accounting concepts is increasingly getting higher, a survey commissioned by PwC shows. The survey, which was conducted among a total of 100 countries coming from all continents and all levels of development, shows that although in 2013 only 26% of the surveyed countries were following the accrual accounting methodology, this percentage is expected to increase to 63% by 2018. Hence there is a clear trend among a lot of jurisdictions to move towards accrual accounting, portraying that the transition to the accrual concepts are gaining universal acceptance.

It is to be noted that a large number of countries decided to apply the accrual-based system as well as to maintain the cash-based system.

International institutions are also following this trend. The Organisation of Economic Co-operation and Development (OECD), the European Commission, the North Atlantic
Treaty Organization (NATO), the Council of Europe, and the International Criminal Police Organisation (INTERPOL) are some of the institutions that are nowadays publishing their financial information in accordance with IPSASs.

2.6.2 Compilation of Financial Statistics

International and supranational institutions, such as the United Nations, the International Monetary Fund, the European Union, the OECD and the World Bank, seem to be following the same trend, with regard to the compilation of Government Financial Statistics (GFS).

In fact, the most prominent macroeconomic statistics on national accounts are based on accrual concepts, namely the so-called SNA (Systems of National Accounts), ESA (European System of Accounts), BPM (Balance of Payment system), GFS (Government Finance Statistics), and the MFS (Monetary & Financial Statements).

SNA data is jointly issued by the United Nations, OECD, IMF, World Bank and the EU; ESA rules are used by EU member states, whilst the other statistical information (BPM, GFS and MFS) is gathered by the IMF.

The international and the supranational institutions, mainly the IMF and the World Bank, have also had a key role in bringing over a change in the accounting method used by national economies. Apart from promoting the usage of a set of reporting rules for
their members, they often oblige their donor beneficiary countries to implement public finance reforms that include, amongst others, a transition to accrual accounting.

2.6.3 European Union

EU listed companies have been required to use the IFRSs (as adopted by the EU) for their consolidated financial statements since 2005 (European Commission n.d.). Yet, there has not been a similar framework to harmonize EU public sectors. Therefore, EU member states have been free to use their preferred method in accounting their public sector.

Yet, in the last five years an interest to regulate this field grew substantially. The Eurozone crisis, which began in 2009, brought devastating results on EU member states. Various countries were finding it difficult to finance their government debt, to the point that they had to seek external assistance from third parties, and some countries were even bailed out. These tragic circumstances revealed the need of a reform in the EU public sector accounting systems.

At present, the Stability and Growth Pact (SGP), which is primarily based on Articles 121 and 126 of the Treaty on the Functioning of the European Union (TFEU) dictates the financial rules on the budget deficit and public debt that member states must abide with or else fall to the Excessive Deficit Procedure. These are:

- 3% in the ratio of the planned or actual government deficit to gross domestic product at market prices;
- 60% in the ratio of government debt to gross domestic product at market prices.

In this respect, ESA defines the accounting conventions that need to be brought in so that the economies of the Member States can be described quantitatively in a consistent reliable and comparable manner (European Commission 1996).

However, the quality of information produced by ESA is notoriously being questionable, as not all EU member states adhere to the same accounting practices (Lüder 2000).

This fact allows governments to perform creative accounting, which refers to the demoralization of loopholes in financial rules to gain advantage or present images in a misleadingly favourable light. In other words, the current system permits governments to hide debts and deficits, report fictitious statistical figures and therefore ward off falling to Excessive Deficit Procedures.

President Van Rompuy, current President of the European Council, states that Europe has learnt the lesson that inaccurate reporting of deficit and debts in the run-up to the sovereign debt crisis had contributed to ill-founded policy decisions and to a collapse of confidence, which led to re-financing problems (European Commission 2013b).

Rompuy maintains that since EU countries are dependent on each other, what happens in one state affects, directly or indirectly, the others. As things stand, accounting comparisons between different EU member states are almost impossible as some states use the cash method of accounting, others use the accrual method, whilst others adhere
to some kind of modified accrual/cash basis of accounting. According to Rompuy, there requires to be a level playing field to bear out the enhanced supervision under the updated fiscal framework, with no possibility for fiscal gimmickry (European Commission 2013b).

The EU direction in this field is the introduction of IPSAS for member states. In fact, the European Commission has been studying the practicability and feasibility of IPSAS on member states since 2011 and is currently working on developing a set of public sector accounting standards specifically for the EU, namely the European Public Sector Accounting Standards (EPSASs).

The European institutions are currently debating to achieve a comprehensive agreement among all stakeholders. Once a consensus is reached, the actual development and implementation of EPSASs could start taking place (European Commission 2013c).

2.7 Opposition to Accrual Accounting

Like any other system, the introduction of accrual accounting by the public sector has its advocates and its critics.

The main criticism is that governments operate very differently from private sectors. Governments are the sole providers of public goods and services, such as lighthouses
and street lightening. The incentive to run these services depends on internal and political pressures rather than on market forces. For these reasons, Guthrie (as cited in Connolly and Hyndman 2010) argues that accrual-based accounting is inferior and inappropriate for public sectors, as government’s raison d’etre is not to increase its own financial wealth. He contends that

financial structure and solvency are not relevant in the public realm; accrual accounting does not measure outcomes; and accrual accounting provides a narrow idea of performance focusing on cost of services and efficiency.

Moreover, Jones and Pendlebury (2010) claim that accrual accounting introduces subjectivity (and a greater measure of judgement) into the accounts of the public sector, namely in measuring assets and in valuing depreciation and inventories. They also contend that the majority of the public sector assets are not feasible, for instance, a motorway could not be sold or that no one would buy a sewer.

Besides, the implementation of an accrual-based accounting involves a considerable level of commitment, in respect of effort, time and money. An interest and support from both the politicians and the senior public sector managers is intrinsic to expand the buy-in and cooperation of key stakeholders and advocate the perks of accrual accounting throughout the organization (PwC Global Survey 2013).

Wynne (2004) lists the complexity of accrual accounting information as another disadvantage. According to him, its intricacy may correspond to less vigilance by Parliament and so the government is less accountable. A lot of Parliament deputies and
of Public Accounts Committees members do not have financial training to understand these new financial statements.

Wynne (n.d. p. 2) maintains that accrual based accounting is only ‘an ideologically contest approach to reform – not modernization.’ Although accrual accounting is very expensive, sometimes even higher than required, it does not offer the benefits claimed for it. At the same melodic phrase of thought are Connolly and Hyndman (2005), who state that there was slight evidence that (accrual) information was extensively employed in decision making.

2.8 The Maltese Public Sector

The public sector of Malta is quite large and historically complex. It has an extensive centralized government structure, whose roots could be traced back to the British administration (Pirotta 2005).

By far, the Maltese Public Sector is the largest employer in Malta, employing around 27% of the Maltese labour force (Economic Policy Department 2013). This percentage includes all the employees working in government ministries, departments, units, local councils, agencies, entities and other autonomous bodies such as the Public Service Commission.
The Maltese Government accounting system has been inherited from the British. The accounting procedures, controls and reporting contents are specified in the legislation. The current accounting framework includes, amongst others, the Consolidated fund Account, the Public Account and other accounts that are referred to as Below-the Line Accounts.

Article 102 of the Constitution of Malta (1964) provides that

all revenues and other moneys raised or received by Malta, shall, unless Parliament otherwise provides, be paid into and form one Consolidated Fund.’

In addition, no moneys shall be withdrawn from the Consolidated Fund except to meet expenditure that is charged upon the Fund by the Constitution or any other law for the time being in force in Malta or where the issue of those moneys has been authorized by an Appropriate Act.

In contrast, the Public Account contains all cash transactions made by Government arising to and from the Consolidated Fund, whereas the Below-the-Line Accounts contain all funds that are merely administered by government (National Audit Office 2013).

The Government Financial Report incorporates the Statement of Revenue, Statement of Expenditure, Statement of Loans made by the Government and Statement of Public Debt, amongst others. These statements are presented annually by the Treasury Department.

All Ministries and Departments are responsible for their own financial data. Data is currently held in the Departmental Accounting System (DAS), a technology based
accounting system that records and controls public spending. DAS permits ministries and government departments to be linked electronically and to conduct Interdepartmental accounting transactions online. However the system is quite old and has become technically obsolete, both in terms of its efficiency, technological developments and operational capabilities.

2.9 Summary of Literature Findings

This chapter explores some of the literature relating to the implications of the shift from the cash based accounting to the accrual basis in public sectors. It has shown that as time is getting by, the demand from citizens to know how the government is utilising their money, as collected through their taxations, is growing. The literature deems accrual accounting as the most effective system to assess the accountability of the government for the resources entrusted to him and to enable better decision-making. Nonetheless, accrual accounting is not easy to implement, requires a lot of money and the results are not guaranteed.
CHAPTER 3

METHODOLOGY

This chapter explains the methodology used for this study, including details on the way participants were chosen and the methods of data collection and data analysis that were used.

3.1 Preliminary Feedback

For this project different research methods were used. Preliminary data on the application of accrual accounting in public sectors was collected to test the viability of the proposed area of research. The main sources of reference were online services and websites. The Maltese Government websites were gleaned to excerpt information on the structure, functions and operation of the Ministry of Finance, the Treasury Department and the National Audit Office, amongst others. In addition, a preliminary interview was conducted with Dr Josette Caruana, a Certified Public Accountant whose
area of research interest is the public sector accounting. This effort was essential to obtain the required knowledge on the subject at the preliminary phase of this research.

3.2 Secondary data collection

Secondary data is data that has already been collected by individuals or agencies for purposes other than those of my research study. A number of literature sources relevant to the study were consulted. Significant reference was made to academic journals, articles, reports and other research studies on the two different methods of accounting and their application in public sectors, together with an interview given by Mr Noel Camilleri, the Accountant General of Malta, published on the ‘The Accountant’ (2014) regarding the adoption and implementation of IPSASs in Malta. The meeting minutes of a session of the PAC, the scrutinising arm of the Maltese Parliament, were accessed after a search on the PAC website. During this session, which took place in 2009, the accounting reform in the Maltese public sector was being discussed. Books were also consulted but to a lesser degree due to the limited amount of information from these sources on this subject.
3.3 Primary data collection

Regarding the collection of primary data, interviews, questionnaires, observations, case studies and portfolios are the tools most commonly used.

The research being undertaken is based on a qualitative method, rather than on a quantitative one, since it involves an inductive and an interpretative research strategy. Lindlof and Taylor (2002) explain that a qualitative interview is ‘an event in which one person (the interviewer) encourages others to freely articulate their interests and experiences’ (p. 170).

A total of 11 semi-structured interviews were conducted to analyse the views and intentions of the people heading the accounting reform in the Maltese Public Sector, as described in Table 3.3.

The interviewees have been chosen according to their experience within the public sector, their expertise in accountancy and their (current and past) involvement in the Maltese Government accounting reform process. Members of the PAC were chosen in their responsibility to oversee and scrutinise the government financial reports.

The interviewees were initially contacted by an email (refer to Appendix 1) that explained the nature of this study and asked them if they wanted to participate.
### Table 3.3: The Research Participants

<table>
<thead>
<tr>
<th>Interviewees</th>
<th>Position of Official/s Interviewed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr John Dalli</td>
<td>Ex-Minister of Finance</td>
</tr>
<tr>
<td>Mr Alfred Camilleri</td>
<td>Permanent Secretary at the Ministry of Finance</td>
</tr>
<tr>
<td>Mr Mark Borg</td>
<td>Director at the Budget Office, Ministry of Finance</td>
</tr>
<tr>
<td>Ms Mariestell Dalli and Ms Claire Lewis</td>
<td>Finance Accounting Managers at Treasury Department, Ministry of Finance</td>
</tr>
<tr>
<td>Ms Tanya Mercieca</td>
<td>Assistant Auditor General at the National Audit Office (NAO)</td>
</tr>
<tr>
<td>Ms Sharon Mallia</td>
<td>Senior Auditor at the National Audit Office (NAO)</td>
</tr>
<tr>
<td>Mr P.J. Baldacchino</td>
<td>Head of Accountancy Department at the Department of Accountancy, University of Malta</td>
</tr>
<tr>
<td>Ms Kristy Debono</td>
<td>Member of the Public Accounts Committee (PAC)</td>
</tr>
<tr>
<td>Dr Justyne Caruana</td>
<td>Member of the Public Accounts Committee (PAC)</td>
</tr>
<tr>
<td>Dr Emanuel Camilleri</td>
<td>Ex-Chairman of the Accrual Accounting Task Force (AATF)</td>
</tr>
<tr>
<td>Dr Alfred Sant</td>
<td>Ex-Prime Minister of Malta</td>
</tr>
</tbody>
</table>
All interviews were carried out face-to-face. They were conducted in the place and time indicated by the participants. All interviews were digitally recorded (with the participants’ consent) and then transcribed. The average time of the interviews was 35 minutes. Some of the interviews were conducted in the English language, whilst others were held in the Maltese language.

3.4 Interview Guides design

I used an interview guide to list the topics and issues to be asked during the interview, rather than using an interview schedule. According to Tracy (2013), ‘interview schedules are standardized scripts of questions, whereas interview guides refer to less formal lists of questions, which are more flexibly drawn upon depending on the situation and the participant’ (p. 143).

The research literature reviewed for this subject provided the theoretical basis for the interview guide of this study. Attention was given to cross-reference my research objectives with the interview questions, so that the interview questions would cover all the objectives of the dissertation.

The interview guide (refer to Appendix 2) facilitated the interview and it was more conversational and informal. It consisted of a combination of close-ended and open-ended questions. Close-ended questions varied from one-answer questions to others requiring rating on the Likert Scale, with questions requiring the respondents to
indicate the extent to which they agreed with the application of accrual accounting in the Maltese public sector, amongst others. Other questions required the respondents to rank their answers in order of importance in connection with their personal opinion.

All respondents were assured of confidentiality, if requested, prior the holding of the interview.

3.5 Data analysis

Once all the interviews were conducted, the data obtained was analysed. Simple statistical tests were used to transpose the qualitative data obtained from the close-ended questions to quantitative. This was done to enable the researcher to have an objective interpretation of the information collected. Tables and bar charts from Microsoft Excel were used where applicable.
CHAPTER 4

FINDINGS AND ANALYSIS

This chapter presents the findings of this study and a thorough analysis of such findings. It is divided into 4 sub-sections: Section 4.1, which analyses the primary changes required for the restructuring of the Maltese Government accounting system (objective 1); Section 4.2, which evaluates whether or not the change to accrual accounting enhances governance, transparency and accountability (objective 2); Section 4.3, which deals with the reasons why such reform is being delayed (objective 3) and Section 4.4, which tries to determine whether it is still viable for Malta to shift to accrual accounting (objective 4). Additionally, a local perspective on the objectives of Government Financial Statements and the major benefits of both the present and the proposed accounting systems is found in Appendix 3.
4.1 The Primary Changes required for the Restructuring of the Maltese Government Accounting System (Objective 1)

Three major changes were identified as essential for the implementation of the accrual accounting reform, namely changes in the accounting treatment of transactions, in the legislation and in the organisational structure.

4.1.1 Accounting Methodology

Undoubtedly, the biggest change should be in how the elements of the financial statements must be recognised and measured. The transition to accrual accounting involves a transformation of the whole governmental finance function.

Under the present cash based approach there are only two baskets, namely cash in and cash out. This serves as an incentive for Ministries and Departments to behave dysfunctionally, as the system tends to encourage them to spend all the available cash at year-end or otherwise they would risk having budget cuts in the following year.

In addition, since DAS is cash based, the government is being constrained to use additional sources to obtain further information on its assets and liabilities. For instance, it has created a Fixed Asset Register to manage its capital resource and a Return of Arrears of the Revenue to control its debtors. Nevertheless, the information obtained from these procedures is generally partial and incomplete. The Fixed Asset Register, for instance, is only kept for internal consumption, does not recognise all governmental fixed assets and no depreciation is being allocated. The Returns of Arrears of Revenue,
on its part, recognises only the account payables that are outside the payment limit period.

It is noteworthy to add that under the cash accounting regime, the cash received from governmental loans and borrowings appears as revenue, thus distorting completely the financial statements that the government publishes.

Apart from that, the exclusion of all assets and liabilities from the government financial reports means that not enough information is being provided on the liquidity position of the public sector.

In contrast, under the accrual accounting methodology, capital expenditures, inventories, receivables, payables and cash inflows from loans, government bonds and treasury bills would all be balance sheet items; whilst the operating and extraordinary revenues (such as the sale of an asset on a one off basis), recurring expenditure, loan interests and depreciation charges would all be items that appear in an Income and Expenditure account, showing the surplus/deficit for the year.

By bringing assets and liabilities into its financial reports, the government would benefit from better management and control of its resources and from accurate information about its long-term spending obligations and borrowing necessities.

This means that the whole financial systems and procedures by which financial information is collected, processed and analysed need to change. The personnel, on its
part, ought to know how to handle the new system and how to appropriately use the new provided information.

4.1.2 Legislation

A new legislation has to be introduced to provide for the preparation and publishing of full accrual-based accounting statements, based on a set of accounting standards.

The Financial Administration and Audit Act (FAAA) of 1962 is currently regulating the receipts, controls and disbursements of public money. It prescribes the accounting procedures and report content, and provides for the audit of government accounts. The law, as it stands, requires the Maltese Government to prepare its accounts on the cash method. Naturally, this detail would need to be amended if the accounting reform is to take place.

One respondent emphasised that the new legislation should also grant wider powers and authority to the Accountant General. At present, the Accountant General, who assumes the role of the Government’s chief accounting officer, is vested with powers to supervise, manage and control all the accounting procedures of the government. However, it does not have authority over ministries and departments to put them under an obligation to account for their accounting transactions before a stipulated date or to constrain them not to exceed their budget limitations.
The lack of real authority for the Accountant General is crippling its ability to introduce fiscal discipline within the public sector. For instance, a lot of public officials decide not to pass the invoices incurred by their ministry/department when the end of the financial period would be near. Ministries/departments do this to conceal the actual amount of their incurred expenditure, thereby gaining from a more favourable financial performance. Then, at the beginning of the new financial period, they start to ‘open the drawers’ and bring out considerable number of invoices, outstanding from the previous financial period.

A number of problems emanates from this faulty practice. First of all, the government would fail in its objective to obtain a real picture of its financial position at the end of an accounting period. Secondly, it would be affecting the annual budget allocations.

Every year the Members of Parliament meet to debate the financial estimates for the following period. At the end of the debate a vote is taken to determine the allocation of funds for the recurrent expenditure and the projections of revenue. Effectively, the allocated budget cannot be fully distributed on the projects that are to take place in the following year, as a large proportion of the estimated money would have to be spent on the concealed expenditure from the previous accounting period.

With regards to the other issue, there are at the moment very restricted procedures to restrain ministries/departments from overspending their budgets. The Supplementary Appropriations bill requires a Parliamentary authorisation on additional or unforeseen expenditure that emanates during the year. However this requirement is very limited,
given that in Malta the government and the parliamentary majority are closely identified with one partly.

4.1.3 Organisational Structure

Another primary change has to take place within the entire structure of the civil service, but especially at the Treasury, the Budget Office and the Ministries and Departments at large.

At the moment, the organisational structure, from an accounting point of view, is geared towards cash accounting. For instance, there are no sections or units in the public sector to monitor (and minimise) the amount of creditors or to chase outstanding payments from debtors. An asset management plan is neither being kept, or else is being kept for statistical purposes only, without utilising the acquired information for decision-making. Besides, there are currently few personnel within government that have an accountancy qualification or an appropriate experience in the accountancy field.

The accrual accountancy reform cut across all governmental departments and sectors. There is thus the need for the creation of new structures and units within each and every Ministry and department in the public sector to cater for the implementation of accrual accounting. New qualified accountants would need to be recruited so that a professional network is created. The non-accountants, on the other hand, should also be given sufficient training. A business reengineering process would be required, whilst the present roles and responsibilities would need to be redefined.
4.2  Would the Change to Accrual Accounting enhance Governance, Transparency and Accountability? (Objective 2)

There is a consensus among all the research participants that the adoption of accrual accounting would eventually result in enhancing the accountability of the government, the public servants and the politicians; in greater transparency, especially by the key spending ministries/departments; and in better governance as a whole (this consensus is illustrated Figure A1.3, which identifies the three main benefits of accrual-based financial statements).

One interviewee explained that the cash basis system was providing a very limited, short-term view of the public sector financial condition. It was failing to provide a reliable statement on the public assets and liabilities, on the financial performance figure and on the cash flows of the government.

This narrow provision of information could possibly enable the government to present an illusion of a favourable picture of its financial position in the shorter-term, to the detriment of the future fiscal stability and profitability. For this reason, the same interviewee concluded that the government financial information could only be credible and hold the Executive to account if prepared on the business-like accrual accounting concepts.

Under accrual accounting, the government would be in a better position to take better decisions, as it would base them on better information systems. Likewise, the
opposition would be more able to point out any illegal or dishonest behaviour, as more information would be available.

4.2.1 Manipulation and Creative Accounting

Once the issues of accountability, transparency and governance were identified, the manner by which the information included in the Public Sector financial report would be manipulated under the accrual accounting was likewise examined.

As the table underneath shows, respondents expressed mixed views on whether the adoption of Accrual Accounting would eliminate manipulations and creative accounting.

Table 4.2.1: Would accrual accounting eliminate manipulations and creative accounting?

<table>
<thead>
<tr>
<th></th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly Agree</td>
<td>1</td>
</tr>
<tr>
<td>Agree</td>
<td>3</td>
</tr>
<tr>
<td>Neutral</td>
<td>4</td>
</tr>
<tr>
<td>Disagree</td>
<td>3</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11</strong></td>
</tr>
</tbody>
</table>
From the feedback obtained from the interviewees, it became evident that the participants with an accountancy background voiced reservations about the possibility that accrual accounting would eliminate manipulations and creative accounting, and preferred to give a neutral answer or to disagree with the question asked.

Another interviewee maintained that the chances for creative accounting would increase under accrual accounting. The IPSASs, as they stand, allow for a lot of flexibility and subjectivity, which in turn make it easier for loopholes to be found. For instance, dates of invoices or the measurement of a one-off extraordinary item could easily be manipulated.

Further, the measurement of certain elements of the financial statements is based on the practitioner’s professional judgement or on a number of estimations. In this regard, the interviewee explained the importance for the government to have more proper internal control structure that detected and prevented fraud once accrual accounting would be implemented. The government should also opt to have a more rigorous statutory audit.

4.2.2 Parliament’s Discussions regarding the Government Finances

One of the interviewees remarked that at present Parliament did not debate the government financial report, as the information it contained was generally useless, meaningless and obsolete. It was solely prepared because the law provided for it.
This means that the Members of Parliament are presently unable to debate whether the Executive has met the specified financial outcomes and objectives or whether the levels of financial accountability and management have been satisfactory. Rather, the focus of the Parliamentary debate is entirely on the Budgetary Estimates.

This absurd situation would come to an end once Statements of Financial Position, Statements of Income and Expenditure, Statements of Changes in Equity and Statements of Cash flows start to be published. The Parliamentary debates would then be able to shift focus on both the government’s past performance and its future projects, in a similar way to what happens in the private sector, where shareholders of public limited companies gather annually to discuss the company’s financial health at the Annual General Meeting.

4.3 Reasons why such a long-winded transition seems so difficult to implement (Objective 3)

The research participants were asked in question 10 of the interview to specify what were, in their opinion, the three main challenges or obstacles that were delaying the accounting reform from taking place at the Maltese central government. As illustrated in chapter 1, the application of accrual accounting at central government level in Malta has been a long winding process and is not yet complete.
The interviewees were given a list of the potential challenges of accrual accounting conversion, namely IT system requirements, cost of conversion, lack of commitment from senior management, lack of trained staff and expected impact on reported financial position. The obtained answers are illustrated in Figure 4.3.

When asked to elaborate, those with an accountancy background stated that manipulations, window dressings and creative accounting had nothing to do neither with the cash nor with the accrual method of accounting. A practitioner remarked that during the last years there were a number of famous cases where commercial companies, adhering to accrual accounting, managed to manoeuvre their financial statements. Cases in point were the bankruptcies and financial scandals that occurred in Enron, which collapsed in 2001, or in WorldCom, which collapsed in 2002.

**Percentage ranked in top 3 challenges of adopting accrual accounting.**

![Figure 4.3: Challenges of accrual accounting conversion](image)
4.3.1 Lack of commitment from management

As revealed in the above bar graph, almost all the respondents were of the idea that there was a lack of commitment, not only by the senior public managers but also by the politicians.

One of the respondents asserted that the transition towards accrual accounting was so complex that the lack of enthusiasm of politicians to introduce it in government was intrinsic. According to him,

\[
\text{this transition is not a matter of a five-minute press conference, but a matter of months and years of preparation and activation. The political actors, in particular, need to have stamina to achieve this goal.}
\]

Unfortunately, the transition in Malta has not been given a political kudos. Politicians, from both sides of Parliament, know that this is not something they would get popular for and there are no political rewards attached to it. Hence, although the process was formally initiated, there has not been enough political impetus to bring it to an end.

Once the political actors were failing to show signs of commitment, the likelihood for the senior public managers to take their own initiative was remote. Probably, they would start to look upon it as an additional chore that would complicate matters, reduce their financial flexibility and, as alleged by one of the respondents, did not enable them to fudge the finance performance anymore.
4.3.2 A case of a political resistance in the implementation of a public policy?

The majority of the research respondents disagreed or were neutral on whether there might have been political resistance in the implementation of the governmental accounting reform process in Malta.

According to them, it was more a question of commitment, investment and priority than of political resistance. The reform was not politically salient in terms of status, votes or political promotion. Therefore, unless there would be a direct involvement or strong commitment from the very top political actor, in this case from the Prime Minister, there would be an internal resistance among different ministries and department towards certain phases of the implementation. One respondent claimed that, in truth, the majority of the politicians did not really understand the concepts of accrual accounting.

Figure 4.3.2: Do you think that this is a case of political resistance in the implementation of a public policy?

Percentage ranked in whether there might have been political resistance in the implementation of the governmental accounting reform process in Malta.
On the other hand, other respondents maintained that the lack of commitment originated from the civil service and not from the political actors. According to them, the civil servants were highly bureaucratic and did not like to change procedures. In addition, one respondent said that sometimes the day-to-day running tasks of a ministry/department simply took over the other operations.

Echoing this statement was another participant, who regarded that in truth the senior public management, namely the Permanent Secretary at the Ministry of Finance, the Head of Treasury Department and the Director General at the Budget Office, did not show a real drive towards modernising the accounting method. Perhaps the reform did not feature prominently on their agenda because they believed that with the change in how statistics were being compiled to the Eurostat, by integrating accrual data collected from the departments with the cash-based data generated from DAS, the initial purpose and concept of the reform died.

4.3.3 Cost of conversion and IT system requirements

As identified in the literature review, the conversion towards accrual accounting requires a lot of investment, both in terms of new IT technologies and human capital development. Malta, for instance, would even need to develop complete new IT systems.

Half of the research interviewees identified the costs of the conversion as one of the top three challenges towards the successful implementation of accrual accounting, and
another 36% identified the required IT systems and coding structures to be major barriers for the implementation of the accountancy reform in Malta (as clearly shown in Figure 4.3 above).

Notwithstanding these issues, other participants regarded that in the longer term the benefits derived from a stronger financial management system in the public sector would outweigh the required costs. Indeed, the computerisation of accrual accounting would bring about several advantages. The new data would be recorded and consolidated in one centralised system, thereby problems of reconciliation and of double processing would be reduced.

The new computerised activities would include, amongst others, a fixed asset management plan, debtors and creditors control accounts, purchase order systems and payroll.

Asset management plans, for instance, would provide information that could be used to determine financing strategies, logistical and supply chain management practices and the best space allocation, amongst other things.

An asset replacement plan, on the other hand, would provide information to be used in determining the repair and maintenance schedules and the asset-disposal decision of every fixed asset. Such information would allow senior public management to identify the opportunities that save cost and to optimise. In particular, asset replacement plans would help management to plan for a replacement of an asset long before it reached the
economic life of zero and thus avoiding to pay extra operational costs from continuing to use an asset that would have reached the economic life of zero, or the likelihood of paying a higher price to acquire a new asset for which it would have been forced to issue a direct order (as an emergency purchase) than issuing an ordinary tender.

Other participants said that they did not think that the conversion was delayed due to costs. In particular, an interviewee asserted the migration towards accrual accounting did not involve very large costs but only ‘a couple of millions.’

In addition, several interviewees remarked that DAS, the current IT system, was outdated and was not technically supported anymore. Accordingly, the government might see the need to replace DAS as an opportunity to change the accounting system all together, given that the cost to obtain a new accounting application still needed to be incurred.

4.3.4 Lack of trained staff

The adoption of IPSAS, or the equivalent, would introduce more complexities than the present accounting system. It is thus simply impossible for governments to introduce accrual accounting without investing a lot of money to develop an effective financial expertise within their public sector.

Technical accounting expertise would not only be restricted to knowledge in accrual concepts, but would also be necessary for other complex areas, such as in calculating the
value of the government’s property (particularly the value of infrastructural, heritage and cultural assets), the intangible assets, the financial instruments, the employee benefits or the pension liabilities. Apart from that, more effort would be needed to determine the time the economic event of every expense and gain occurs, so that these could be recorded at the period to which they relate.

At present the Maltese public sector lacks an accounting qualified work force. In fact, a significant number of civil servants lack accounting knowledge, expertise and skills. Maybe the government is failing to attract qualified accountants because the remuneration offered by private firms is substantially higher.

Some interviewees identified the lack of trained staff as yet another possible variable delaying the Maltese accountancy reform. These interviewees subscribed to the opinion that the government must engage within the civil service a considerable number of Certified Public Accountants and must also offer a lot of training to the present non-accounting personnel, if accrual accounting was to be adopted. One of the participants, who happened to be a Certified Public Accountant working within a public institution, stated that even the present qualified personnel would require a lot of training to gear up for the new reporting requirements, let alone the non-accounting staff.

Conversely, another interviewee reasoned that the issue of trained staff could not be related to the slow pace of public accounting reform. Despite agreeing in principle with the argument put forward, he recalled that significant training programmes were always available in the past years, especially between 2001 to 2004, where batches of 500
people were specifically trained in accountancy at an advanced level. Additionally, a Higher Diploma in Public Accounting and Finance started being offered at the University of Malta as of 2010.

Besides, the same interviewee pointed out that the migration towards accrual accounting did not require each and every civil servant, with a job duty associated with accountancy, to be an expert in the accountancy field. Indeed, the clerical staff or the line managers, would not be required to understand the entire accrual accounting methodology, but only to be knowledgeable in using the system to match up to their particular job duties and responsibilities.

4.3.5 Expected impact on reported financial information

One of the research participants argued that there was a political resistance, from both political parties, to the implementation of accrual accounting, owing to the fact that the political parties expected a big variance on the reported financial figures once accrual accounting would be introduced.

However, another participant remarked that the expected impact would be a once-only adjustment. At the same time, it was true that on the one hand the government could get a readjustment backlash, but on the other hand, it would get the kudos for introducing a modern and more transparent system, something that would count in its favour.
On this issue, another participant stressed that the timing of when a governmental reform would take place was politically very important. According to him, the best time for the government to implement the accounting reform in Malta would be straight away after being elected following a general election.

4.3.6 Other factors that might be creating an unfavourable environment for the implementation of a government accounting reform

The interviewees mentioned other reasons that they believed were unfavourable factors for the actual implementation of the government accounting reform.

Perhaps the fact that, till now, there have been no EU regulations that required member states to apply accrual accounting might have acted as a disincentive to the adoption of accrual accounting in the Maltese central government.

Upon becoming an EU member state, in 2004, Malta was required to report and submit financial information to Eurostat on an accrual basis. This is somehow being addressed by a system of patched-up cash-based accounting data. Essentially, the cash based data is being supplemented with accrual-based data to meet the requirements of ESA 95.

One of the interviewees claimed that once Malta joined the EU, the Maltese authorities concentrated their attention on meeting the reporting requirements of ESA 95, at the expense of abandoning the migration towards full accrual accounting.
Additionally, the Maltese Government, especially the Ministry of Finance, has been constrained to dedicate a substantial part of its energy, time and limited human resources on making sure that the Maastricht criteria are being satisfied.

In contrast, one of the respondents argued that the initial transition towards accrual accounting in some developed countries appeared to have been instigated by a period of financial stress. Fortunately, Malta has not experienced any problematic financial situations in the recent years.

4.4 Is it still crucial for Malta to shift to accrual accounting?  
(Objective 4)

When asked whether the current patched-up accounting data was providing reliable information about the country's fiscal health, the responses provided differed marginally between one interviewee and another. Such responses are clearly illustrated in table 4.4 underneath.

Almost all the respondents agreed that the current patched-up cash-based system was quite primitive and provided limited accrual based information. At the moment, government officials are compiling questionnaires and templates on the inventories, prepayments, debtors, cash, accruals, creditors and their capital commitments of their ministry/department, and supplement them to the Treasury Department
The Treasury Department, on its part, performs some procedures to check that the acquired data is accurate. For instance, the data gathered from the templates is compared to what is shown at the DAS to check for any large inconsistencies between the two sources. However, the extent of this monitoring is very limited, while the said data is not audited. In essence, the Treasury is relying, to a large extent, on the accuracy of the data it is obtaining. For this reason, when asked to give their opinion on whether the patched-up cash-based accounting data was reliable, the majority of the respondents preferred to remain neutral, arguing that its reliability depended on how accurate the person filling it was.
In contrast, one particular interviewee was very extreme in his response. He argued that the patched-up cash-based accounting data was all ‘rubbish’ and that the Eurostat was reporting ‘rubbish’ across the board, as, according to him, the system permitted and allowed manipulations.

This opinion was contested by another interviewee, who stated that the Eurostat had a specific set of activities, policies and procedures in place that were designed to ensure that the presented information was complete. In addition, he deemed that the introduction of full accrual accounting would not produce results that would be very different than what was being produced at the moment. According to him, the information being currently provided was very reliable.

Nevertheless, all the interviewees confirmed that it was still crucial for Malta to shift to full accrual accounting. Besides the fact that the financial statements would be more robust, consolidated and detailed, the accrual accounting system would even save money in the longer term.

4.5 Conclusion

This chapter presents and analyses the findings of this study. It reveals that the process to restructure the Malta Government accounting system is massive, and it thus cannot be implemented overnight but over a number of years. The accounting reform in Malta
is nevertheless being hampered by a number of factors, mainly by the lack of commitment shown by the top political actors and the senior public bureaucrats. The next chapter provides the major conclusions of this study, along with a number of recommendations.
CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

The final chapter of this study identifies the major conclusions from the analysis of the results and maps out a set of recommendations that are deemed to be relevant to the implementation of accrual accounting at Malta’s central government (objective five). Suggestions on areas of further related research are also provided.

5.1 Major Conclusions

The introduction of accrual accounting at the central level of Malta is continually being delayed because the present statistical reporting requirements for Eurostat (ESA 95) are being achieved with the current patched-up cash-based accounting system. As a result, the priority, motivation and interest for an accounting reform at Malta’s central government are being lost.
This assertion reflects the lack of commitment shown by the top political actors and the senior bureaucrats that are involved in the Maltese accounting reform. In fact, the politicians and the high level administrative officials continuously project themselves as if they are committed to act, even though they have no intention to do so or have no idea what the requirements of the reform entail. This explains why the introduction of accrual accounting is often given prominence in the annual Budget Speeches and yet nothing transpires.

The research that was conducted indicates also that the Maltese authorities are not utilising the information that is given to the Eurostat for decision-making purposes and are collecting it for statistical purposes only. The generated output is thus not being used as a management tool to improve and enhance efficiency and effectiveness of the Maltese public sector.

5.2 Recommendations

Having determined the major variables that are stalling the accounting reforms at the Maltese central government, this section draws up a set of recommendations that, once implemented, would lead to the successful application of accrual accounting. The recommendations, which are based upon the data collected throughout the dissertation, have been divided into three, targeting the accounting methodology, the enactment of a new legislation and other recommendations.
5.2.1 Accounting Methodology

It has been established that the accounting policies, standards and guidelines that define the accounting methodology at the central government of Malta need to change.

The Accrual Accounting Task Force (AATF), in its first years, drafted the Maltese Government Accounting Standards (MGASs) as the set of financial reporting standards to be implemented once the accrual accounting system in the Maltese central Government would take place. These standards were nevertheless abandoned in 2011 in favour of IPSASs, as the latter were thought to be more credible (one must note that both the MGASs and the IPSASs never acquired any legal basis).

However, it is clear that, from a local perspective, the formulation of a set of accounting standards that are specific for the Maltese Government would be preferred than adopting a set of international accounting standards. In other words it is best to use only a subset of the IPSASs and remove many of the optional accounting treatments. This would make it simpler for public servants to comply with the resultant standards. Furthermore, tailor-made accounting standards take into account specific public sector accounting issues and could be formulated in a way to simplify the accounting treatment of the financial elements, as IPSASs allow a lot of options on how the elements of financial statements are to be recognised and measured that could also give rise to creative accounting. Besides, specific accounting standards could be written in a non-technical version so that the non-technical people (such as the government clerks) would be able to read and understand them easily, without the need to be qualified in accounting.
Undoubtedly, the decision by the government to establish its own set of accounting standards requires the creation of an independent standard-setting body that is free from any ministerial and political influences.

5.2.2 Enactment of New Legislation

The formulation of a new Public Financial Management Act, which would repeal the current Financial Administration and Audit Act of 1962, is essential for the completion of the accounting reform in Malta. This sub-section outlines some of the required amendments to the law. Table 5.2.2 provides the main recommendations related to the legislative aspect.

Table 5.2.2: Legislative Recommendations

<table>
<thead>
<tr>
<th>Functions and Responsibilities</th>
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<tr>
<td><strong>The Accountant General</strong></td>
<td><strong>The Accountant General may after obtaining approval in writing from the Minister responsible for finance, stop moneys from being utilised by a Ministry or a department if that Ministry or department do not conform to the Financial Management Regulations.</strong></td>
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<tr>
<th>Accounts &amp; Reporting Requirements</th>
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<tr>
<td><strong>Authority to manage public moneys</strong></td>
<td><strong>1. Subject to the provisions of this Act the Minister may by regulation delegate to Permanent Secretaries, Heads of Department and the Accountant General authority to manage public moneys and render account thereof.</strong></td>
</tr>
<tr>
<td>Access of the Accountant General to official financial documents</td>
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<td>---------------------------------------------------------------</td>
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<tr>
<td>2. Wherever necessary to discharge his/her duties in complying with any instructions of the Minister issued under this Act, the Accountant General may inspect and make copies of any official books, records and other documents or copies thereof, and require, when possible, copies in electronic format of any such official document to be produced to him.</td>
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<tr>
<th>Financial Statements</th>
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<tr>
<td>3. (1) All financial statements shall be prepared in accordance with the Financial Management Regulations.</td>
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<td>(2) Notwithstanding anything contained in this Act or any other Act, the financial statements of Government shall be submitted for each financial year.</td>
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<th>Accounting and Financial Reporting Structure</th>
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<td>4. The accounting and financial reporting structure shall be in accordance with the Financial Management Regulations.</td>
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<tr>
<th>Monthly and Quarterly Financial Statements</th>
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<td>5. Monthly and quarterly financial statements shall be prepared in accordance with the Financial Management Regulations.</td>
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<th>Auditing of Annual Financial Statements</th>
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<tr>
<td>6. Permanent Secretaries and Heads of Department shall, not later than ten calendar weeks after the close of a financial year, submit to the Accountant General financial statements in respect of that financial year, certified by an independent certified public accountant and auditor.</td>
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<th>Submission of Consolidated Government financial statements to Auditor General</th>
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<tr>
<td>7. (1) The Accountant General shall, not later than three months after the close of a financial year, forward to the Auditor General the consolidated government financial statements and the financial statements as certified under Section 34 of this Act and as submitted by Permanent Secretaries and Heads of Department.</td>
</tr>
<tr>
<td>(2) The Auditor General shall examine in accordance with the Auditor General and National Audit Office Act, 1997, the statements which the Accountant General is required to submit under subsection (1) of this section</td>
</tr>
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</table>
| Submission of Annual Report to Minister for publication | 8. (1) The Accountant General shall, not later than three months after the close of a financial year, submit to the Minister for publication a report on the finances and accounts of the Government in accordance with the Financial Management Regulations.  
(2) Upon receiving the Report mentioned in sub-section (1) of this Section, the Minister shall cause it to be published and shall lay a copy thereof before the House of Representatives at the first sitting of the House immediately after such publication. |

### Investments and other Assets

| Establishment of an Asset Management Advisory Board | There shall be an Asset Management Advisory Board that shall take stock of all assets, tangible and non-tangible of the Government and make recommendations regarding the acquisition and disposal of such assets. The constitution and functions of the Asset Management Advisory Board as well as the valuation methodology of the Government Assets shall be defined in the Financial Management Regulations. |

### 5.2.3 Other Recommendations

Ultimately, the move from the cash to the accrual basis of accounting entails a change in the mentality and mindset within the civil service, as it transforms the entire finance function of the government. This calls for extensive training programmes for the respective civil servants, recruitment of qualified accountants and consultations among all the relevant stakeholders, including the politicians. Such an understanding among all the stakeholders would be crucial to facilitate the transitional period that leads to the new accounting system and financial reporting practices.
Additionally, the system that replaces DAS should not only support the accrual accounting principles but also continue to support the present cash accounting methodology. In this way, the application of accrual accounting could take place in a gradual way, ensuring that the full transition occurs only when all ministries and departments are ready (in terms of competency).

The organisational structure of the Budget Office, the Treasury and the National Audit Office (NAO) should also be reviewed and updated to cater for the introduction of accrual accounting. There should be a strong link between the Budget Office and the Treasury as their tasks are very related to each other; the former is concerned with the variance between the actual and the budgeted cost, whilst the latter is mainly concerned with the cash flow. The NAO, on the other hand, needs an upgrade in its technical skills and capabilities, as the implementation of accrual based financial statements requires it to give an assurance on whether the government financial reports are true and fair. Likewise, the members of the Public Accounts Committee (PAC) must be informed about the technicalities of the new system to be able to analyse the financial statements in a comprehensive way.

Ultimately, it is to be noted that the proposed change to accrual accounting requires a number of years to take place in its entirety, has to proceed in stages and cannot be implemented overnight. It needs to have an owner, who is capable of co-ordination, and should be backed with appropriate legislation. The governmental strategic team is required, amongst others, to devise a holistic strategic roadmap, set the appropriate
project management structure, tailor the conversion tools and communicate the project strategy across the whole sector.

## 5.3 Areas for Further Research

This dissertation has highlighted the variables underlying the Government’s accounting reform in Malta. Nonetheless, the issues surrounding government accounting and financial reporting are very extensive and by no stretch of imagination has this study come close to exhausting them. Specific areas could not be elaborated upon in too much detail, for instance on how the introduction of accrual accounting could result in the introduction of cost accounting and the building of a complete management information system at the Maltese public sector. Further other areas of studies have thus been identified to complement this study.

Particularly, further research needs to be carried out on the issues that other countries had to face during their transition process and the benefits they eventually achieved. The experience of other countries serves to enhance Malta’s risk management purposes, although it is also pertinent to say that a system that works in one country might not necessarily work in another and thus the specific Maltese needs should always be kept in mind.

Another area that requires particular attention is the implementation of accrual accounting budgets. An accrual accounting budget takes into consideration the assets
and liabilities of an organisation and thus provides better insights for informed decisions as the long-term impacts of the political choices would be considered. This calls for a study on whether an accrual accounting budgetary framework, and the ensuing comparisons between the budgetary and actual figures, would improve (or not) the present situation at the Maltese central Government.

Eventually, when the public sector reform is achieved with the full implementation of accruals based accounting and the employment of more qualified accountants, further research could be done to identify and analyse the benefits that have been achieved in relation to the expenses incurred, and to find out whether the additional information that would have been obtained contributed to the quality of future decisions, policies, objectives and strategies, and to the public financial management. Apart from that, one could also study whether such reform would have affected the public image of the Maltese civil service.
APPENDIX 1

The following email message was sent to all the interviewees before holding the interview:

Dear Sir/Madam

I hope this email finds you well.

My name is Frank Attard. I am a Bachelor of Commerce (Hons.) Public Policy student reading through the last year of my course. As part of my academic studies and assessment, I am preparing a dissertation concerning 'Variables Underlying the Government’s Accounting Reform in Malta.

As part of my dissertation, I am required to carry out a number of interviews and this is the purpose of this email. I am kindly asking your help to provide me with any feedback that you can offer.

I would be pleased with your collaboration. I am willing to meet you at a convenient place and time. All information and response will be treated with the strictest confidentiality.

Thank you.

Best regards,

Frank Attard
APPENDIX 2

The following interview guide was used during all the interviews that were done for the purpose of this study:

1. What are, in your opinion, the objectives of government financial reports?
   Who are the main users of government financial reports, and what are their requirements?

2. In your opinion, what are the three main advantages of the cash based accounting system?
   a. Low administrative and accounting cost
   b. Lack of subjectivity, as depreciation, inventories, etc are not recognized
   c. Straightforward and easily understood
   d. No financial expertise is required to apply it
   e. Less time consuming
   f. Other advantages

3. On the other hand, what are the three main advantages of accrual accounting conversion?
   a. Enhancement in transparency and accountability
   b. Improvement in measuring a realistic financial performance and financial position
   c. Ability to compare data from other governments, from individual government units and from the private sector.
   d. Recognition of inventory of assets and liabilities
   e. Enabling cost control and increases efficiency
   f. Providing additional users both for the government and for other stakeholders
   g. Other advantages

4. Can you explain the major deficiencies of the present cash accounting system?
   Is it faithfully representing the state of public finances?
5. The number of countries choosing to adhere to accrual based accounting systems is increasing. Yet, a lot of critics argue that accrual accounting is not appropriate for public sectors, as these operate differently from the private sector and their objective is not to maximize income or profit.

Do you agree with the application of accrual accounting in the (Maltese) public sector? Why?

Rate the level of agreement: 0 to 10
0 do not agree at all
10 fully agree

6. What would be the primary changes that the transition would bring about?

7. Accrual accounting will enhance governance, transparency and accountability.
   a. Strongly agree
   b. Agree
   c. Disagree
   d. Strongly disagree

   Elaborate

8. Accrual accounting will eliminate manipulations and ‘creative accounting’
   a. Strongly agree
   b. Agree
   c. Disagree
   d. Strongly disagree

   Elaborate

9. Should the new accrual-based financial statements be published to the general public in full or in a simplified version?

10. In Malta, the process to migrate from the cash to the accrual method of accounting was formally initiated in 1999. All accounting stakeholders seem to be in favour of the transition, while there also appears to be a consensus between the two major political parties.
Yet, fifteen years have passed and the process is still ongoing.

What are, in your view, the primary challenges and obstacles delaying the conversion to accrual accounting in Malta?

a. IT system requirements
b. Cost of conversion
c. Lack of commitment from senior management
d. Lack of trained staff
e. Expected impact on reported financial position
f. Other

Can you elaborate?

11. Do you think that this is a case of political resistance in the implementation of a public policy?

a. Strongly agree
b. Agree
c. Disagree
d. Strongly disagree

12. As a member of the European Union, Malta is required to report financial information on an accrual basis. At the moment, this is being addressed by a system of patched-up cash-based accounting data.

Is this patched-up cash-based accounting data providing reliable information?

Rate the level of information’s reliability: 0 to 10

0 – no reliability
10 – very reliable

If yes, would it still be viable for Malta to introduce the accrual method of accounting, keeping in mind that such transition involves large amounts of costs and a lot of work effort?
APPENDIX 3

GOVERNMENT FINANCIAL INFORMATION: FINDINGS

Appendix 3 tackles the objectives of Government Financial Statements and the major benefits of both the present and the proposed accounting system.

With reference to Appendix 2, the first part of the interview questions was targeted towards achieving a general insight on the objectives of government financial information, its users and the major benefits of both the cash and the accrual method of accounting.

1.0 Objectives of Government Financial Information

All the interviewees agreed that the main objective of government financial reports, like all types of financial reports, is to give a true and fair view of the financial position and performance of the government.

Further, the governmental financial reports are prepared to provide financial information that is useful to a wide range of stakeholders for decision-making purposes.
The government financial reports are also a means to monitor and ensure the accountability of the government for the resources entrusted to it.

1.1 The Users of Government Financial Information

The users of Government financial reports are grouped into two categories, namely the insider group and the outsider group.

The internal financial management team is perhaps the main user of financial information, as it continuously needs to monitor and study the economic trends to formulate fiscal policies and to manage the public debt.

The internal financial management team includes the Finance Ministry, the Treasury and the Budget Office to name a few. Additionally, Permanent Secretaries, Directors Generals and other senior bureaucrats entrusted with the management of ministries and departments need to know the actual amount of their revenues and expenditures to compare them against the budget allocated to them and to plan and organise themselves better. Politicians also need to understand the country’s financial position before committing themselves for new initiatives and programmes.

In contrast, the Maltese Parliament, the National Audit Office, the Public Accounts Committee and the European Commission are considered to be the main external users...
of Government financial information. They discuss, audit, scrutinise and review the presented financial results to ensure that these are properly prepared and are in compliance with established criteria.

The general public is also considered as one of the external users. The public at large has the right to know how the money, collected through taxations, is being spent. In addition, the financial information enables citizens to evaluate and make informed adjudication on the country's financial health.

In reality, the general public does not seem to be very interested in reading the government financial reports or to care about what accounting system the government uses. They find it easier to rely on members of the House of Representatives, the constituted bodies, the academics and the media to go through them on their own behalf and to act in a way to ensure that the government finances are faithfully disclosed.

Other external users that might be interested in the Government financial information are the business community, trade unions, banks, stockbrokers, credit rating agencies, trading blocs and international financial institutions, such as the International Monetary Fund (IMF) and the World Bank.
1.2 Application of Accrual Accounting in Maltese Public Sector

Invariably, all the interviewees consider the application of accrual accounting in the Maltese public sector as an essential task that adds more information to the government financial reports and enhances their relevance and reliability. There was a general agreement that the present government financial reports, prepared under the cash method of accounting, are not faithfully presenting the state of public finances and are leaving the readers with an insufficient picture.

One of the respondents added that the present accounting statements reported the cash inflows and outflows from every ministry and department in quite a lot of detail. However, significant information was totally being ignored, such as the amounts of tangible and intangible assets, the account payables and receivables, the accruals and prepayments and the inventory figures (including the work in progress). In chapter 2, 2.1, one can read about the different methodologies of both the cash and the accrual accounting systems.

1.3 Benefits of both the Cash and the Accrual Accounting Systems

In questions 2 and 3 of the interview, the respondents were asked to specify what were, in their opinion, the three main benefits of both the cash and the accrual accounting systems.
The interviewees deemed the low administrative and accounting cost in the preparation and presentation of the financial information as the main advantage of the present cash based accounting system, followed by its relative simplicity, straightforwardness and ease in understanding; its lack of subjectivity, as under cash accounting there were no options on how the elements of the financial statements were to be measured, and would be less time consuming.

Having said that, a number of the interviewees claimed that these so-called advantages did not justify governments’ reluctance to introduce accrual accounting. Rather, these (advantages) were the reasons why governments, in the past, had opted for cash based accounting.

Another interviewee added that it was true that under cash accounting the government would not be required to hire accounting experts or to offer training to the non-financial employees. However this would mean that there would be a lack of accounting knowledge in the civil service and that the public sector accounting staff would not be capable to understand or interpret the figures they presented.

When asked to identify the main benefits of the accrual accounting system, the most common replies from the research participants were the enhancement in transparency and accountability and its ability to measure a realistic financial position. One of the research participants pointed out that all other benefits, such as the ability to compare data from other governments, from individual governmental units and from the private sector; its capability to control costs and increase efficiency, the recognition of assets
and liabilities and the provision of additional information for the policy makers would lead to the first two. This information is clearly illustrated in Figure A1.3 below.

**Figure A1.3: Benefits of accrual-based financial statements**

![Diagram showing benefits of accrual-based financial statements]

**Percentage ranked in top 3 benefits of adopting accrual accounting.**

2.0 The Extent to which the Government Financial Statements should be published

When the research participants were asked how they would prefer the new accrual-based financial statements to be published, whether in a full or in a simplified version, a large number of them remarked that if the system would comply with IPSASs, then it needed to abide with the requirements of said standards.

Having said that, the majority of the interviewees agreed that they would prefer the Government to issue its annual financial statements in full, stating that there would be more transparency and information to the public at large, particularly to the investors.
and academics. One of the interviewees even said that the government financial statements should be published in all Maltese papers on an annual basis.

Other participants stated that only an abstract should be published, otherwise the government financial statements would be massive and overloaded with excessive information. Rather than focusing on the amount of figures, it would be better to give a thorough analysis of the disclosed figures, as the analysis that is currently given is rather poor.


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