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Misappropriation of assets in local authorities: A challenge to good governance

Rozaiha Ab Majid^a, Nafsiah Mohamed^a, Rosmawati Haron^{b*}, Nor Bahiyah Omar^a, Betsy Jomitin^a

^aAccounting Research Institute, Faculty of Accountancy, Universiti Teknologi MARA 40450 Shah Alam, Selangor, Malaysia

^bFaculty of Accountancy, Universiti Teknologi MARA, Johor, KM12, Jalan Muar, 82500 Segamat, Johor, Malaysia

Abstract

Misappropriation of assets is indeed becoming a major concern in the public sector. In this paper, we will attempt to frame the results survey on assets misappropriation that might occur in two city councils. It is found that the incidence of misappropriation of assets occurs when employees used the official vehicles, computers, and facilities for personal interest. Even though the impact might not significant, yet, if it is left untreated, the symptom will become an incurable disease. As a result, the trivial instalments will create tremendous impact on the financial waste due to the unnecessary expenditure incurred.

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1. Introduction

The Malaysian government authority is divided into three hierarchy; Federal Government, State Government and Local Government. Since 1957, Malaysian government has undergone several transformation programs which evolve from a guiding role of a newly independent country into an innovative motivator in economic development. The transformation however, has experienced a jump start since 1980s when Federal Government has massively

* Corresponding author. Tel.: +607-935-2106; Fax: +607-935-2381

E-mail address: rosma741@johor.uitm.edu.my

launched a transition of privatization policy where the public sector has befallen into a facilitator of private sector and service provider for public (Abdul Khalid, 2008).

The role of local authority has significantly changed over the years, for it plays a key role in indigenous economic growth and implementation of national development plans and policies of the government (Ahmad Sarji & Mahmud, 1993). The mission, objectives and functions of local authority have, in fact, undergone various degrees of reform, especially under the influences of various, complex changes in public policies, development strategies and initiatives (Phang, 1997). As the lowest rank in Malaysia government structure, local authorities serve direct to the community for their functions are to plan, to develop the area and to provide basic amenities. Section 39 of Local Government Act 1976 has provided the local authorities to generate their own revenues through licenses, taxes, permits, tradings and investment. Notably, changes nowadays are more daunting than the past.

Ultimately, the success of the local authority lies in the hands of its employees. There is an increasing awareness of the urgent need to address the issue of “misconduct” among its employees. As shown by the KPMG Forensic’s 2008-2009 Integrity Survey, the prevalence of serious misconduct in government and public sector of which local authority is grouped, stood at 56%.

Fraud can occur at various levels of the organization. The wave of corporate scandals, beginning in 2001- 2002 with Enron, WorldCom, and others, led to the recognition that deficiencies too often existed in the governance and internal control systems of all types of organizations. Reactions to these deficiencies have resulted to Sarbanes-Oxley, and internal control audits under Section 404 which has witnessed to an increase in attention to the issues of governance, internal control, and fraud detection by auditors, management, and the broad investment community. While there have been many high-profile cases in the corporate world, the governmental and not-for-profit organizations are also not immune from major fraud.

As challenges grow, the community in the public sector somehow has vague impression on the limit of acceptable and unacceptable behaviour (PwC, 2010). In a study conducted by Ab Majid (2010), misappropriation of assets is indeed a concern in Malaysia’s local authorities. In the study, the findings have shown an alarming sign of misappropriation of assets which has been classified to (highest score):

1. Vehicles; and internet connection
2. Computer equipment
3. Stationery
4. Telephone usage

It is also found that unethical behaviours are common sight among the employees and some perceived that the activities are legal. The consequences of this act are the employee’s personal enrichment and the organization’s losses (Steward, 2007).

Given the critical importance of this issue, this research has two-fold aims. This paper will examine the reality of assets misappropriation in Malaysian local authorities and to seek the employees awareness on the issues. It is hoped that the findings are capable to offer certain highlights to the management of local authorities that such unethical behaviour might survive. As such, appropriate actions can be outlined in order to curb the problems so that loss in assets and revenues can be reduced.

2. Previous studies

Tan Sri Dato’ Setia Haji Ambrin bin Buang, the Auditor General of Malaysia in his opening remarks at the National Seminar on Forensic Accounting and Financial Criminology 2008 interpreted fraud as “intentional misrepresentation of information by the management, employees or third party in order to gain an illegal advantage”. The examples of the acts, among others are omission of transaction from records or documents and misappropriation or misapplication of assets.

According to the Association of Fraud Examiners, fraud happens when an employee deliberately misuses the asset in the organization he works for. The causes might due from lack of segregation of duties to lack of effective penalties for this white collar crime (Huefner, 2011). For whatever reasons and definitions of fraud that would bring, it comprises of illegal acts that would benefit the perpetrator at one hand and squander the victim on the other hand.

Misappropriation of assets is one of the branches of fraud. According to Greenlee, Fischer, Gordon, and Keating, (2007) previous studies have indicated that frauds are likely to take place in nonprofit – organization and government sector, thanks to the fragile internal control, trust issue, difficulties in verifying certain revenue and expenses and blurred in policy and procedures of public procurement. The scenario is worsening when there is little admission of fraud in government sector due to the belief that it will tarnish the image of the authority. (Jones, 1993)

In a survey conducted by Ziegenfuss in 2001, he found that presence of a strong ethical environment contributed to lower incidence of fraud. Nearly all (96 percent) the respondents to his survey felt that fraud was a significant problem for local governments, and most (57 percent) felt the incidence of fraud would increase in the future. Among the reasons cited for the expected increase were:

1. Poor management practices;
2. Weakened social values;
3. Economic pressure;
4. People not held responsible for their actions; and
5. Inadequate training for those responsible for fraud prevention and detection.

On the other hand, Campos and Pradhan (2007) proposed that the incidence of misappropriation of assets occurs when the government servants used the official vehicles, computers and facilities for personal interest. The episode runs from small misuse of stationeries to misuse of official vehicles (Orchard, Decker and Kiziran, 2007). The impact might not significant, yet, if it is left untreated, the symptom will become an incurable disease. The trivial installments will create tremendous impact on the financial waste due to the unnecessary expenditure incurred. (Orchard et al, 2007). Chapple, Ferguson and Kang (2007) also supported the motion by indicating that misappropriation of assets committed by employees are often in relatively small and immaterial amounts, which therefore, they are difficult to detect. This is because the management is able to camouflage the misappropriations in ways that are ambiguous.

Nevertheless, Green and Calderon (1994) believed that red flags could be used to signal the occurrence of misappropriation of assets. The red flags are a situational indicators and evidences in signalling the likelihood of misappropriation of assets for example official vehicles being used for personal errands or government's computer being used for personal usage. With the existence of red flags as indicator, that should lead to suspicion by the management (Uretsky, 1980).

3. Methodology

We have selected two local authorities in order to fulfil our research aims. We choose to employ convenience sampling for the selection of city councils, which we made based on the descriptive results found by Ab Majid (2010) and Jomitin (2011) in their studies. Their results have shown similar outcomes on misappropriation of assets regardless of total assets and total employees employed in local authorities all over Malaysia. Our research instrument was through survey which later we tabulated the response in comparison between the two local authorities. In order to protect privacy and confidentiality, we have denoted both local authorities as City Council A and City Council B. Our main focus was to capture descriptive data on the likelihood of misappropriation of assets in the local authorities. The questions were segmented into three situations which we designed to appropriately address the research objectives. The responses were structured in Likert Scale of 1 (Strongly Disagree) to 5 (Strongly Agree). The survey has been distributed to 300 employees of the city councils, however, only 62 were returned and usable.

4. Findings and discussions

4.1 Scenario 1: Usage of official vehicles for personal benefit.

The settings of scenario 1 were surrounded on the usage of official vehicles to transport employees' children to or from schools. Table 1 showed that 63% of respondents from City Council A agreed with the situation that the practice is common. Even though respondents in City Council B showed 22% disagreement of the practice, still, the percentage of employees who have responded that it is a common practice was not dissimilar to the City Council A.

Table 1: Scenario 1

		City Council A	City Council B
		%	%
This is a common practice	Agree	63	56
	Neutral	23	22
	Disagree	13	22
My colleagues are doing the same thing	Agree	53	59
	Neutral	27	19
	Disagree	20	22
I think that is not against the law	Agree	0	3
	Neutral	20	10
	Disagree	80	87
My superior has given me the permission	Agree	10	3
	Neutral	20	31
	Disagree	70	66

Not only that, almost half (53%) the other employees (colleagues) were practicing the same thing. Interestingly, 80% of them agreed that the scenario was against the law but there was no action taken against the employees. In addition, employees were given permission by their superior to use official vehicles for personal use (63%). However, the percentage showed by city Council B is slightly lower as compared to City Council A. 56% of respondents from City Council B believed that the situation is a common practice.

4.2 Scenario 2: Usage of councils' computer, printer, and stationeries for family members.

Scenario 2 is given based on the setting where a daughter of a city council employee uses the official computer and printer to complete her coursework. The daughter is also described as using the office's paper while printing her coursework. Based on the scenario, 80% of respondents from City Council A considered it as a common practice whereas only 44% of respondents of City Council B agreed. Interestingly, 84% of them agreed that the scenario was against the law but there was no action taken against the employees.

Table 2: Scenario 2

		City Council A	City Council B
		%	%
This is a common practice	Agree	80	44
	Neutral	3	22
	Disagree	16	34
My colleagues are doing the same thing	Agree	90	50
	Neutral	3	22
	Disagree	6	28
I think that is not against the law	Agree	3	6
	Neutral	20	10
	Disagree	77	84
My superior has given me the permission	Agree	0	3
	Neutral	33	44
	Disagree	66	53

4.3 Scenario 3: Usage of council's office equipment and materials for private consultation.

Table 3: Scenario 3

		City Council A	City Council B
		%	%
This is a common practice	Agree	70	31
	Neutral	23	13
	Disagree	7	56
My colleagues are doing the same thing	Agree	53	34
	Neutral	33	9
	Disagree	13	56
I think that is not against the law	Agree	0	0
	Neutral	23	16
	Disagree	77	84
My superior has given me the permission	Agree	3	3
	Neutral	33	25
	Disagree	63	72

From Table 3, it can be seen that most of the respondents of City Council A believed that utilisation of councils' office equipment and utilities for professional private consultation is a common sight at their workplace. However, only 31% of respondents of City Council B have the same opinion.

Based on the analysis of the findings from the three scenarios above, majority of the respondents agreed that the given scenarios were common sights at both local authorities. These results seem to be consistent with the results from KPMG in 2008-2009, where 74% of respondents agreed that they had personally observed or had first-hand knowledge of wrongdoings within their organisation. It has to be noted that the most alarming scenario of all is the respondents are aware that the exercises are against the law. Nonetheless, no actions are taken as they are given permission by their superior.

This analysis provides evidences of the possibility of seriousness of the issue of misappropriation of assets in city councils. This may be due to a lot of factors, among others, were opportunity to misappropriate the assets, ineffective internal control system, lack of awareness and level of fraud education among the officers. Remarkably, there were respondents who thought that the cases were not against the law especially in Scenario 1 and 2.

5. Findings and discussions

Given that the scenarios given were based on convenience sampling, there is sufficient room to debate whether these two city councils faced problems of assets misappropriation by their employees. Based on our analysis, it can be concluded that misappropriation of assets in both local authorities; City Council A and B, happens. Even though most of the employees of the City Council understand the seriousness of misappropriation of assets; however they were still doing it. The findings of this research can be used as an indicator to measure the seriousness of misappropriation of assets in local authorities as a whole.

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