

## The Reforms of Budgeting System in Malaysia

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### ABSTRACT

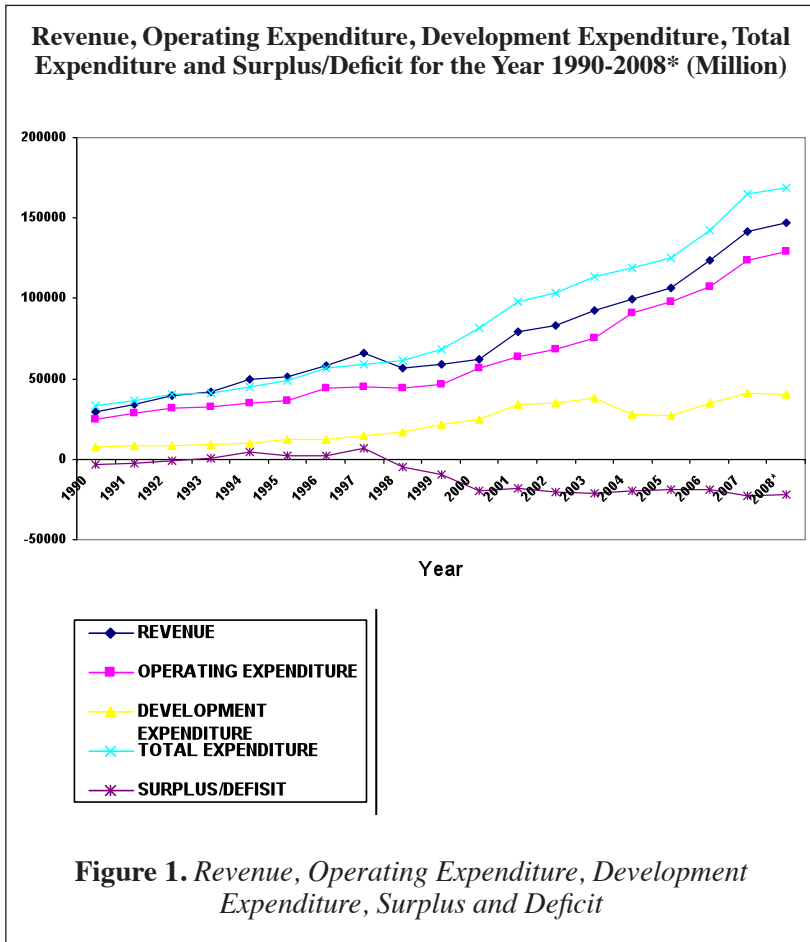
*The purpose of this study is to analyze the reformation of Malaysian budgeting system, specifically in the context of Malaysian federal agencies. Budget deficit in Malaysian economy has long been subjected to criticism for, among others, inefficiency, ineffectiveness accountability and poor performance. These issues have paved the way for budget reforms and reorganizations seeking to address the weaknesses and enhance the efficiency and performance of budgeting. This study can be regarded as the first attempt to explore the reformation of budgetary system in Malaysian government. The improvement of the budgeting performance is important in order to provide further impetus to the national agenda of socio-economic development, dynamic socio-economic environment, nation-building, globalization, competitiveness and the enabling mechanisms.*

**Keywords:** *budgeting system, performance, government agencies*

### INTRODUCTION

Malaysia as a developing country has a range of scarcity of resources and unlimited of budget spending pressures are forcing governments to become more economy, effective, efficient and accountable for the use of publicly generated fund. Therefore, the budget deficit in Malaysian economy has long been subjected to criticism for, among others, inefficiency, ineffectiveness accountability and poor performance. Such criticism has paved the way for budget reforms and reorganizations seeking to address the weaknesses and enhance the efficiency and performance of budgeting. Doh Joon Chien

(1972, 1984), discussed about the Malaysian budgeting systems. He commented on the following issues: over-emphasis on the technical aspects and neglect of human variables; little attention to develop understanding, receptivity and capability in using data; inadequate support from top level administrators; lack of trained staff; inadequate support from the Treasury itself; and trained staff being promoted to unrelated jobs. This was further supported by Dean (1990) who highlighted areas that are lacking in the budgetary systems. This includes the following: lack of commitment; lack of trained personnel; information generation and use; and lack of central agency support and technical difficulties.



Source: Economic Report (1990-2008)

Following to that issue, during the implementation of the Program and Performance Budgeting System (PPBS) in 1969 and continue with the Modified Budgeting System (MBS) in 1990, the amount of budget spending increased moderately compared to government revenue and it caused to the budget deficit as shown in Figure 1 (Economic Report, 1970-2008). While, budget deficit 3.5% in 2014 has attracted the attention of investors or stakeholders on the assumption as the root caused of inefficiency and poor performance. It further asserts that the problems of the government deficit, are so pervasive and deep-seated that they cannot be resolved simply by altering the structure of budgeting system. After the adoption of Modified Budgeting System (MBS) in 1990 until 2008, the amount of government spending increased tremendously compared to government revenue as shown in Figure 1 (Economic Report, 1990-2008).

### **BUDGETING SYSTEM IN MALAYSIA**

Improving the performance of budgeting is particularly important in order to provide further impetus to the national agenda of socio-economic development, dynamic socio-economic environment, nation-building, globalization, competitiveness and enabling mechanisms. In Malaysia, the line item budgeting was inherited from the British upon independence. Basically, the line item budgeting system had focus for detailed line item requirements of a ministry or government agencies. Through this system, the federal budget had divided into three vote head which are emoluments, other charges annually recurrent and other charges such as special expenditure. Specifically, line item budget divided by spending unit or activity centers which may have several programs. Through this system, budget prepared annually, with year-end rush to spend with typical incremental approach favoring existing programs, regardless of priority. Based on line items of expenditure, control is on inputs rather than outputs or impacts. Basically, reports are for compliance purposes, by institution and approved cost, usually detailed and reports for stabilization purposes and control over aggregate need additional economic classification.

Xavier (2002) claimed that the line item budgeting would be ideal for budgeting and control at the departmental and lower management

levels not for the national level because it would not conduce for promoting performance or achieving objectives. Therefore, all the weaknesses in line item budgeting system is the reason of government to introduce the new budgeting system namely as Program Performance Budgeting System (PPBS).

Malaysia implemented PPBS in 1969 through 1990. The PPBS as one of the management tool for the better control and planning of government expenditure. This budgeting system was enabled to help management department to make a better decisions on the allocation of resources among alternative ways to achieve government objectives. On the other hand, PPBS requires all departments to propose their budgets from cost benefit analysis estimation (Ganeswari, 1994).

The focus of budgetary process in line item budgeting includes the information on the performance of program and activities. Budget process is considered as a tool of funds disbursement rather than a strategic management tool. Empowerment and delegation of authority to make decisions on resource utilization also limited. There is a dichotomy in decision making process on financial matters and matters pertaining to policies and implementation of program or activities and the approach to planning and budget preparation was *Bottom-Up* approach (Lynch, 1995). In 1985, Peter Dean, the United Nation Inter-Regional Adviser was appointed to evaluate the progress of performance measurement of PPBS. From the report output, Dean (1986) concluded that financial management including budgeting in the government really weak and it urgently needed to do a reformation.

The modified budgeting system was officially introduced for the 1990 annual operating budget preparation with the issuance of Treasury Circular No.11, 1988. The implementation of MBS had stated in three pilot ministries, the Ministry of Health, Ministry of Work and Ministry of Social welfare (Malaysia Treasury, 1988). In 1997, the system was implemented in relevant Statutory Bodies that received allocation for operating expenditure from the Treasury (Malaysian Treasury, 1996).

The MBS was developed to counteract the weaknesses of the PPBS through optimization of resource allocation, improved program performance while increasing the level of accountability. It was

based on philosophies of Result Based Management (RBM) using an Integrated Performance Framework to drive results. The MBS introduced on the basis of *let managers manage* using a *Top-Down* planning methodology where managers were empowered to generate outputs as cost efficiency as possible resulting in program effectiveness. Basically, the main objective of MBS is to promote a rational allocation of resources to government program. This rationality of MBS is to achieve fiscal limits upon agencies and forging a link between inputs and outputs. It also seeks to promote better program management through the adoption of better management practices.

In practice devolution of authority, MBS seeks reoriented the focus of accountability on issues of program efficiency and effectiveness. Programs and activities are to be evaluated to assess their impact and relevance. Managers would be held accountable for performance. In reciprocation, they would be given greater flexibility in managing resources. The mismatch between accountability (for outputs) and authority (over resources) would thereby be eliminated as managers would be responsible for both.

To that extent, MBS has four main features to design the meaningfully related input and output. The first feature is expenditure target (ET) which represents a budget ceiling for on-going program. The Treasury will estimate the resources which required by government agencies to execute their existing program in the same way which it had done in the past. The ET will encouraged government agencies to identify the most important program or activities to be implemented in the current year (Hussaini, 1989). The ET amount is measured by using this formula,

$$\text{ET} = \text{Previous Year's Allocation} - \text{One Offs} + \text{Salary Increments} \\ + \text{Inflation rate} + \text{Exchange Rates Variations} - \text{Efficiency} \\ \text{Dividend.}$$

The ET will be considered as a part of total allocation which is given by treasury department to the government agencies in implementing their program. The total of overall allocation can be calculated by using this formula,

Total Allocation = Expenditure Target + New Policy (including One Offs) Allocation – One-Off Allocation given the previous year + Savings.

The second characteristic of MBS is Program Agreements (PA)- is representing as an agreement document between treasury department and other government agencies. It requires all agencies to commit themselves in preparing a set of performance targets for a proposed level of funding that the ministry or department suggest for each activity in a program (Xavier, 2001). In addition, in MBS the Exception Report (ER) should be submitted by governments' agencies to the treasury department, if the performance of any program fall outside predetermined variance ranges of targeted performance. Treasury Circular (1988), suggested the report should indicate the extent of the inconsistency, the reason for it and the remedy to prevent its recurrence.

The third characteristic of MBS is the cycle of program evaluations which seeks to evaluate the activities of the program at least once in a cycle of five years. Output achievement will be evaluate from quality aspect, quantity, timeliness and cost used. In addition, the result of this evaluation is to be the basis for the annual adjustments to the expenditure targets and also as a decision on new policy proposals relating to program extensions (Treasury Circular, 1988).

Finally, the generalized approach to expenditure control has been designed as a control process in estimate the total allocation for implementing the program. This action will be done by reducing the allocation step by step on some program. Xavier (2002) stated that the generalized approach to expenditure control is an effort at empowering departmental management, an agenda that had been domain under PPBS. The MBS has eliminated line item controls from the central budget process. It encourages the virement powers to be passed down to lower levels of management. Hence, the lower level managers should now have opportunity to design a resource mix to enhance program performance. Through implementing this element, MBS aims to enhance the decision making capacity of lower levels of management which significant to the concept of '*let managers manager*'. As discussed, budget reforms perceived to improve the agency program performance through some modification

on PPBS and application a good budgeting system. Further, to the extend of understanding of budget reforms, Xavier (2001), illustrated the differences among the budgeting practice in term of system features, budget preparation, budget examination, budget control, accountability and extent of delegation as shown in Table 1.

**Table 1:**

*Line Item Budgeting, PPBS and MBS – A Comparison*

	Line Item Budgeting	PPBS	MBS
1. System Features	Line Item Budget plan with line item classified under three heads, that is, emoluments, other charges annually recurrent and other charges, special expenditure	Budgeting within a program structure-activity structure. Budget documentation required setting objectives, performance targets and line item inputs for each activity. Annual program evaluation/review. Delegation of authority.	Budgeting within an output focused program-activity structure and within a predetermined expenditure target. Budget documentation in the form of contracts of performance and performance exception reports. A cycle of program evaluations requiring each activity to be evaluated at least once in five years. Increased delegation of authority.
2. Budget Preparation	Budgeting by detailed line items	Budgeting by standard objects of expenditure (line items) within program and activities. Bottom up approach to budget preparation (originally envisaged to be top-down).	Top-down approach through the setting of fiscal limits. Input classification is by general (broad) objects of expenditure.

*(continued)*

	Line Item Budgeting	PPBS	MBS
3. Budget Examination	Input Focuses	Input focuses	Output Focuses
4. Budget Control	Input Focuses	Input focuses	Output Focuses
5. Accountability	Fiduciary compliance with rules and regulations.	Fiduciary compliance with rules and regulations	Efficiency and effectiveness besides fiduciary accountability.
6. Extent of Delegation	Nil	Limited – Virements only between two of the five general (broad) objects of expenditure within an activity (i.e. emoluments, permanent charges & grants)	Virements across all categories of expenditure within and across activities in the same program.

*Source:* John Antony Xavier (2001) in *Budgeting for Performance*

Table 1 compare line item budget, PPBS, and MBS to illustrate the shift from the input to output orientation and the greater delegation of authority envisaged under MBS. These reforms represent a shift in the public sector management paradigm from progressive public administration to new public management. Under the new paradigm, budgeting and accountability were no longer to be input focused. They were to be output oriented to champion budgetary planning, control and accountability on behalf to improve agency program performance (Xavier, 2001). However, Xavier (1996) rightly argues that one of the main weaknesses of the MBS is that it does cover the whole of the budget process and the related institutional arrangements, but focuses only on operating budget processes.

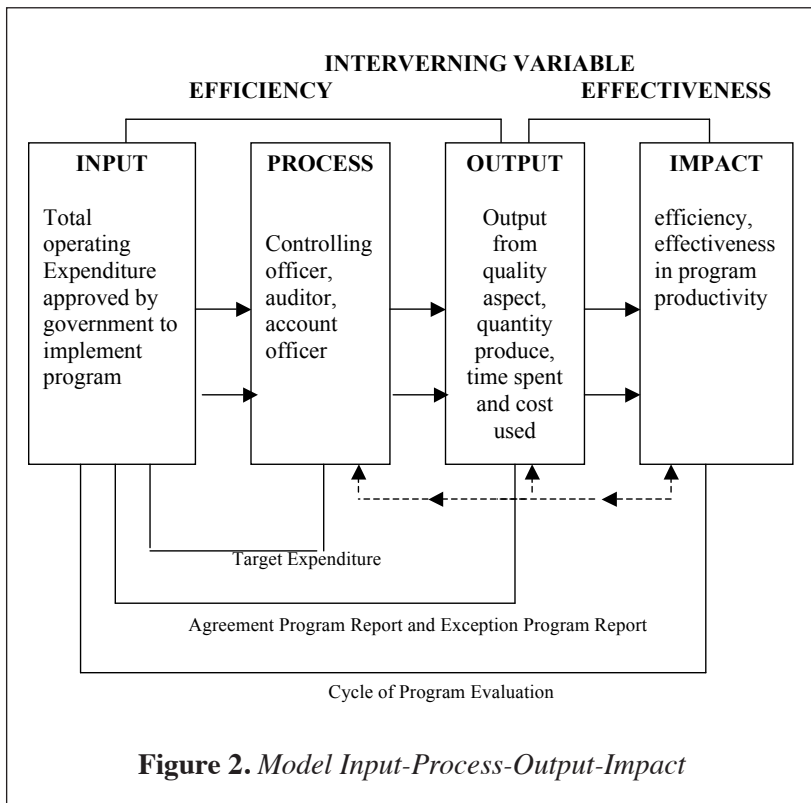
The development budget is another part of budget process, which is operated and monitored by Economic Planning Unit of the Prime Minister's Department. The reason for separating these two types of budget is tightly link with government's agenda for economic development. Regarding institutional arrangements, Xavier (1996) contends that the MBS as a piecemeal reform program is not concerned



about factors that impinge on the whole budgeting exercise, including management information system, financial management rules, and supply procurement procedures. Xavier (1996) fails to recognize that central government has been embarking on a comprehensive reform agenda to enhance the institutional agenda of public bodies.

### BUDGETING PERFORMANCE

The MBS model is similar to the input-process-output model (Figure 2), initially applied by the Easton (1953). The model in Figure 2, links three main elements, which are input, process and output which demonstrates the existence of linkage between input, process, output and impact which involved the ET, PA and program assessment carried out by the implementation government agencies in the MBS.



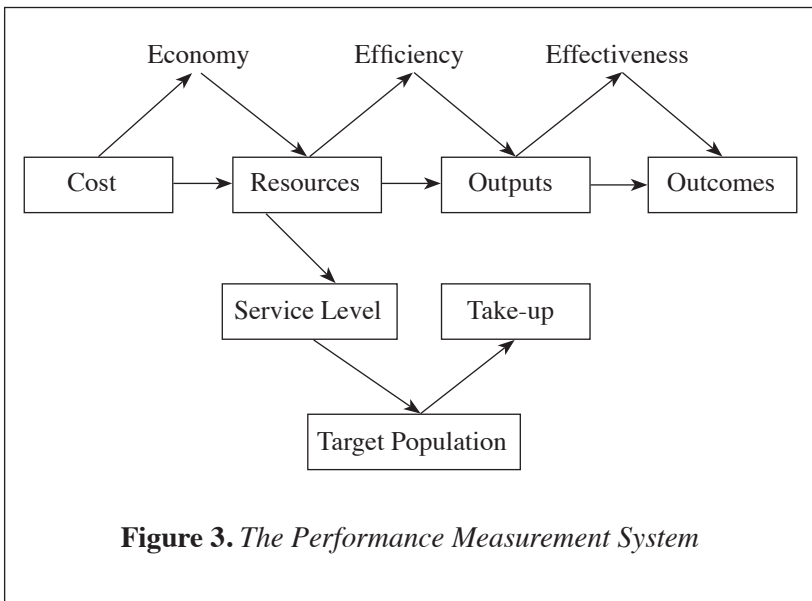
**Figure 2.** Model Input-Process-Output-Impact

Source: Lynch (1995).

In this model, input involved total operating expenditure approved by government to implement the program. Secondly, output is considered as the output achievement in quality aspect, quantity of output, time spent and cost used. Thirdly, to produce the output, this system should process the input which involved controlling officer, auditor, account officer, and officer at civil servant department. Finally, after produced the output, the impact can be measured through the efficiency and effectiveness in the program productivity. Easton's Model, Audit Commission (1986) has considered performance as the important factor underpinning the management process. They argued that performance consisted of two key elements, efficiency and effectiveness. Service efficiency defined as the provision of specified volume and quality of service with the lowest level of resources capable of meeting that specification. Service effectiveness, on the other hand was defined as provided the right services to enable the agencies to implement its policies and objectives. Audit Commission (1986) also had an economy, in the context of purchases from outside being of the lowest possible cost consistent with the specified quality and quantity. They argued that, while inputs and outputs could usually be measured, the result in terms of effectiveness was more difficult to define. However, they stated that input/impacts which cannot be quantified must still be considered, otherwise the measureable (cost) would drive out the not measureable (quality) (Ghobadian, 1994). Audit Commission (1986) produced the input, output, efficiency and effectiveness measure for different local authority in term of four levels of performance measurement.

The model in Figure 3 shows the dimension or level at which measurement occurs (cost, resources, outputs and outcomes). It also shows the performance indicator and the relationship between the measures. It is common practice in public sector performance management literature to talk about three E's of economy, efficiency, and effectiveness, based upon a simple input, process and output model of organizations (Flynn, 1997; Rouse, 1999; Cartier et al., 1995). Other authors have suggested similar broad span approaches to performance measurement. Fitzgerald et al. (1991) suggest that performance in service organizations should be measured across six dimensions included result-competitiveness and financial performance, determinants of results-quality of services, flexibility,

resources utilization and innovation. Palmer (1993) suggested that government performance needs to measure economy, efficiency and effectiveness. Economy is defined as acquiring resources in appropriate quantity and at least cost. Efficiency is defined as maximizing output for a given set of inputs, or minimizing inputs for a required output. Together economy and efficiency are consistent with notions of financial accountability to terms, and data such costs, volume of service and productivity are relatively simple to measure (Palmer, 1993).



**Figure 3.** *The Performance Measurement System*

Source: Audit Commission (1986).

Measure economy and efficiency is consistent with Fitzgerald *et al.* (1991) categories of resources utilization and financial performance. Effectiveness is defined as the extend to which the defined task has been accomplished (Palmer, 1993) and is consistent with notions of non-financial accountability to the local community. Effectiveness may partly be measured in item of quality of service, customer satisfaction and achievement of goals, but such indicators appear less than efficiency indicators (Palmer, 1993).

Many researchers focused mainly on budgeting performance and performance measurement in public sector. Thus, some of them largely ignored about the budget reforms and its implication on program performance despite the dramatic changes taking place through out this sector.

## CONCLUSION

This study can be regarded as the first attempt to explore the existing budgetary system of government agencies and its associate to the good performance. Accordingly, it is necessary to provide a detailed impact assessment of Malaysian budget reforms. Based on worldwide experience with respect to budget reforms and Malaysian government's expectation of its reform programs, changes in major categories of program and activities such as operational efficiency and effectiveness of programs and accountability in the implementation of budget reforms will be assessed in the future study.

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