The Timeliness of Recognizing Accounting Income in Malaysia: The Influence of Government Linked Companies Transformation Programme

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ABSTRACT

This paper investigates the quality of financial reporting in Government Linked Companies (GLCs) and the effect of GLC's transformation programme on the timeliness of accounting earnings in the Malaysian Market. This paper also compares the timeliness of earnings between the GLCs and Non-GLCs. This paper follows the model of Ball (2003) and estimates a linear pooled regression of accounting income on change in market value of equity during the period of 2004 to 2009. The method facilitates the determination of the timeliness of the accounting record to reflect economic gains or losses. The analysis shows that the quality of income in GLCs is higher than Non-GLCs. The results reveal that incremental economic losses sensitivity is more before the transformation programme compared to periods after the transformation programme and that economic gains recognition improves post year 2006 in GLCs. While there is an overall decline in the timeliness of losses recognition (in both GLC and Non-GLC groups), there is some improvement in the recognition of economic gains post year 2006. The results presented may be attributed to some transformation programmes implemented in GLCs and Non-GLCs. It is also acknowledged that the results could also be affected by the new IFRS implementation in year 2006. Yearly analysis reveals that there is no consistency in the effect of incremental economic losses sensitivity, which requires specific investigation into the incentives and specific forms of decisions in the future. While prior studies look at the timeliness of economic gains or losses recognition across countries, this paperattempts to investigate the issue of quality financial reporting in GLCs and how the implementation of the government transformation programme is able to have a significant impact on financial reporting in GLCs.

Keywords: Financial reporting quality; timeliness; corporate governance; government linked companies; transformation; Malaysia

INTRODUCTION

The purpose of this study is to investigate the effect of governance improvement in government linked companies on the quality of financial reporting following the government transformation programme. The quality of financial reporting, to a large extent, depends on how standards are implemented. Ball, Robin and Wu (2003) studiedfour East Asian countries – Hong Kong, Malaysia, Singapore and Thailand. Each of the four countries claimed that their financial statement presentation and disclosure is influenced by the International Accounting Standards (IAS), and the overall legal system is according to the common law regulation. This common law based standard is viewed as being of "high quality" and should result in more timely recognition of economic losses compared to countries adopting a code of law system. This is because the latitude provided by the principle based standards would enable the managers to make judgments in order to signal the underlying economic substance and value of the firm to uninformed financial statement users.

However, there is significant variation in the timeliness of both economic gains and losses recognition even within the four IAS and common law based countries. Ball et al. (2003) conclude that the quality of financial statement depends on the domestic institutional environment of the country, culture, the appointment of manager, and the political involvement, which could influence the incentive of the preparer in presenting quality financial reports.This argument is consistent with Sloan (2001), Haniffa and Cooke (2003), and Mohd Saleh, Iskandar and Rahmat (2007) who suggest that the quality of financial statements is related to good corporate governance and cultural values.

This study further investigates the quality of financial statements by focusing on the quality of financial reporting in Government Linked Companies (GLCs) incorporated in Malaysia for the period of 2004 to 2009. This issue is of particular interest because, first, GLCs mostly consist of companies established from the government privatisation programmes. This sector contributes significantly to the overall economy of Malaysia by controlling more than one-third of the market capitalisation of the capital market. Second, the setting provides a unique opportunity to investigate the role of government investment in corporations and how it influences financial reporting. The results from this study can clearly demonstrate the effect of government involvement in companies that could influence the preparer's incentive to signal information or to mislead users. A fresh insight into this issue is important, particularly in developing countries, due to the undeniable

quantum of government involvement in business. This research utilizes the timeliness of recognising economic gains and losses as the parameter to measure the quality of financial reporting. Additionally, this study also contributes to the literature by examining the effect of whether the GLC transformation programme effectively enhances GLCs financial reporting performance and directs them to achieve their mission according to the policy fixed by the stakeholder. This research will also help the government to evaluate whether their existing approach in monitoring and controlling GLCs is effective and provides guidance for future improvement in formulating government policy.

This paper is organised as follows. The next section describes the characteristics of GLCs and the transformation. Section 3 reviews the literature related to financial reporting incentives to develop the research hypotheses. Section 4 presents the research method, which includes samples, measurement of research variables and model. Section 5 deals with the results and discusses the research findings results and discussions. The last section concludes this study.

AN OVERVIEW OF GLCS OPERATION IN MALAYSIA

In terms of their ownership and controls, the model of GLCs in Malaysia is quite similar to other state-owned enterprises in other countries such as Egypt, Bangladesh, Greece, France, Germany and the United Kingdom (Ahmed 2008; Ezad & El-Masry 2008). These GLCs are monitored closely by the government. Because the government has a huge financial investment in these GLCs, the monitoring capabilities of the government in ensuring the competitiveness as well as performance of GLCs has been subjected to questions from various interested parties (Ang & Ding 2006).

Historically, there are many criticisms concerning the performance and management of GLCs, which resulted from the government's bailout of Bank Bumiputera Malaysia Berhad (BBMB) during the 1980s. BBMB came to the public's attention when the bank's subsidiary in Hong Kong was involved in a loan scandal and was helped by Petroleum Nasional Berhad (a national oil and gas company), which injected billions of Ringgit of fresh funds into the ailing bank (Mohd Saleh 2003). However, the second crisis in BBMB occurred in 1989. After new management took over BBMB and increased appropriate bad debt provisions, the bank's operations reported a loss of RM1.06 billion. This time the government introduced a bail out package of fresh funds and a conversion of loan stocks held by Petroleum Nasional Berhad into equity (Friedlan 1989). Similar bail out programmes involving Malaysian Airline Systems and Renong conglomerate

happened during past economic crises, costing billions of government money. These companies were not classified as GLCs then. These firms were denote as GLCs since the government makes substantial capital investment in these companies.

However, the issue of government assistance to firms is not new and not only confined to developing countries. In the United States, the government spent billions of dollars in subsidies, grants, reduced taxes and subsidised credit to help firms in their corporate restructuring. The justification of such an effort is the benefit to the public. These assistances were claimed to promote improved management practices, efficiency and productivity that will lead to increased economic growth and consumer satisfaction (Champlin & Knoedler 1999).

In order to show that GLCs are always competitive and satisfy the concerns of various parties the Government issued a guideline for improving the performance of GLCs in March 2006. This guideline is known as "the guidelines for improvement transformation in GLC for development of Malaysia to be a developed country". The objective of these guidelines is to create sustainable improvement by exercising good corporate governance in GLCs. Finally, good governance is expected to be translated into good financial health and strong performance in GLCs.

Ensuring the financial health of GLCs is important in an economy. In 2006, GLCs contributed 36% or RM260 billion of the total capital market of the Kuala Lumpur Stock Exchange (KLSE) (now known as Bursa Malaysia). In the market, with a total market capitalisation of more than RM1 billion in March 2010, the Employees Provident Fund (EPF) presently dominates the daily trades (up to 50%) in the equity and bond markets of Bursa volume. Therefore, the importance of investigating GLC companies with respect to their reporting quality and how the government transformation programme has impacted the reporting quality is undeniable. It is hoped that the high reporting quality would assist governance mechanisms in monitoring the company management and, in the end, contribute to the long term sustainability of the GLCs performance.

CHARACTERISTICS OF GOVERNMENT LINKED COMPANIES

DEFINITION AND CATEGORY

State owned and controlled companies (now termed as GLCs) are one of the project initiatives under the New Economic Policy.[1] The establishment of GLCs was derived from the initiative to restructure and redistribute economic income to the Bumiputera[2] and non-Bumiputera following a racial riot on 13th May 1969.

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[1]   The New Economic Policy or Dasar Ekonomi Baru (DEB) is a socioeconomic programme in Malaysia which was introduced in 1971 by the prime minister (then) Tun Abdul Razak Dato' Hussein. The main objective is to achieve national integration and unity.

[2]   Bumiputera or Bumiputra is a Malay term widely used in Malaysia, embracing indigenous people of the Malay Archipelago.

According to the Circular of Putrajaya Committee on GLC High Performance or PCG[3] (2006), GLCs are defined as companies that have commercial objectives but under the direct interest or control of the Government of Malaysia. This interest refers to the power and capabilities (normally according to the percentage of shareholding) in appointing members of the Board, senior management, and decision making for GLCs (i.e. in contracts, strategy, restructuring, financing, procurement, investment etc.). They are owned either directly by the government (through the Ministry of Finance Incorporated) or through the Government Linked Investment Company (GLIC).

The GLIC is defined as the investment company related to the Federal Government that allocates partly or fully their capital for investment in GLCs. These GLICs accumulate funds from the public in the form of mandatory contributions or voluntary investment, which is fully guaranteed by the government. This company is under the influence of the Federal government in appointing the Board and senior management and in setting the period for individual reporting to the government. Examples of GLICs include Kumpulan Wang Simpanan Pekerja (Employees Provident Fund), Khazanah Nasional Berhad (an investment holding company of the Government of Malaysia), Kumpulan Wang Amanah Pencen (Retirement Fund Incorporated), Lembaga Tabung Angkatan Tentera (Armed Forces Fund Board – an agency under the Ministry of Defence), Lembaga Urusan Tabung Haji (Malaysian Hajj Pilgrims Fund Board), Kementerian Kewangan Diperbadankan (Ministry of Finance Incorporated) and Permodalan Nasional Berhad (Government of Malaysia 2006b).

From the total number of GLCs, 15 companies are held by the constituent GLIC. These GLCs are known as Group 15 (G-15) and have in average of 65% of the capital market. The 15 GLCs are Maybank, Telekom Malaysia Berhad, Tenaga Nasional Berhad, Sime Darby Berhad, Bumiputra-Commerce Holdings Berhad (Previously Commerce Asset Holdings Berhad), Golden Hope Plantation Berhad, Malaysian Airline System, Proton Holdings Berhad, Kumpulan Guthrie Berhad, Affin Holdings Berhad, UEM World Berhad, Boustead Holdings Berhad, BIMB Holdings Berhad, Malaysian Resources Corporation Berhad and Malaysia Building Society Berhad. Other GLCs are either controlled by the Ministry of Finance Incorporated, State-Owned Companies or Khazanah Malaysia[4] (Government of Malaysia, 2006b).

GLCs are controlled by the Malaysian Government. Thus, political pressure could have a significant influence on the preparation of the financial report. The majority of the Board of Directors (BOD) of GLCs are Bumiputera (Haniffa & Cooke 2002). They can have cross directorships of up to a maximum of five companies (Haniffa & Cooke 2002). According to Haniffa and Cooke (2002), Malay leadership is characterised by high power distance, low masculinity, high uncertainty avoidance and low individualism. Thus, based on the Malay culture, the tendency of the directors is to adopt high secrecy values and, thus, lead to low disclosure of information (Gray 1988; Haniffa & Cooke 2002).

GLCS TRANSFORMATION PROGRAMME

The guideline for "the transformation of GLCs for the development of Malaysia to be a developed country" was first circulated in March 2006. The objective of this guideline is to create sustainable improvement environment by implementing good corporate governance practices in GLCs. This circular explains the pathway for GLCs transformation according to phases. Phase 1 covers the period for GLCs to mobilise resources, diagnose problems and plan for transformation, which covers 14 months. Phase 2 discusses the method for GLCs to generate the momentum for transformation. This phase covers a period between 12 to 17 months after the transformation manual was published at the end of July 2005. In phase 3, tangible results and sustained benefits across all GLCs are expected to emerge. Finally, in phase 4 several GLCs would be expected to become regional champions while others are performing at par with their competitors. A detailed explanation of the long term GLC transformation programme is shown in Figure 1.

The GLC transformation long term programme circular is expected to have a significant impact on the quality of financial reporting. One of the characteristics of good corporate governance is dealing with succession planning and strategic business planning. In the GLC scenario, this characteristic is elaborated in depth in the "Green Book", which is related to guidelines for board mechanisms to enhance the efficiency of the company. The Green Book suggests that directors of GLCs are expected to implement an actionable improvement programme by December 2006. This means that the effectiveness of the board in generating positive results could be seen for the periods after 2006 (Government of Malaysia, 2006a), depending on how fast the improvements can be translated into results. Thus, this study assumes that GLCs that adopted this circular would experience an increase in the management effectiveness after the circular was issued. This management effectiveness includes issuing quality financial reporting, i.e. in terms of the timeliness in recognising gains or losses.

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[3]   PCG is chaired by the Second Finance Minister, with participation from the heads of the Government-Linked Investment Companies.
[4]   Khazanah Nasional was incorporated on 3 September 1993 as a public limited company and governed by the Malaysian Companies Act of 1965.

	2005	2006	2007	2010	2015

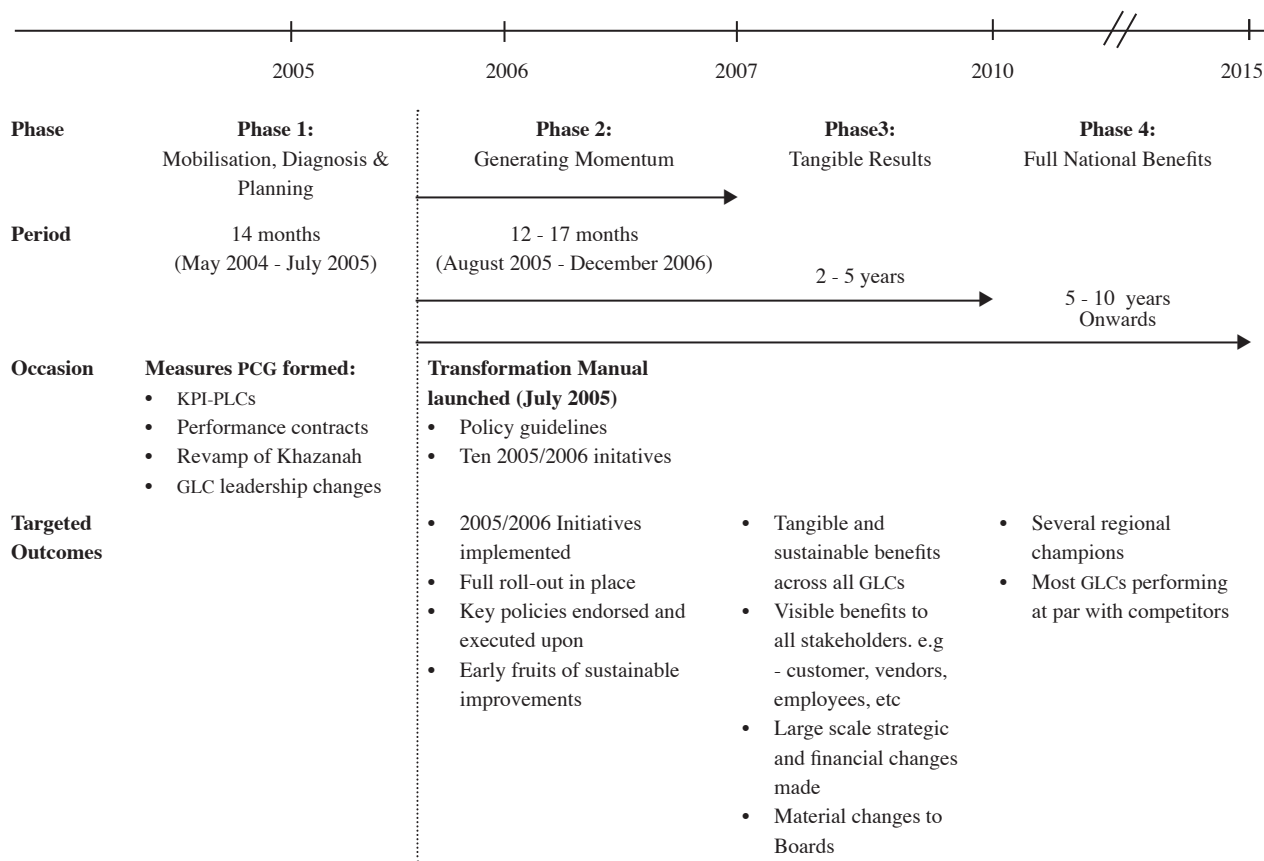| Phase	Phase 1: Mobilisation, Diagnosis & Planning	Phase 2: Generating Momentum	Phase3: Tangible Results	Phase 4: Full National Benefits
Period	14 months (May 2004 - July 2005)	12 - 17 months (August 2005 - December 2006)	2 - 5 years	5 - 10 years Onwards
Occasion	Measures PCG formed: • KPI-PLCs • Performance contracts • Revamp of Khazanah • GLC leadership changes	Transformation Manual launched (July 2005) • Policy guidelines • Ten 2005/2006 initatives		
Targeted Outcomes		• 2005/2006 Initiatives implemented • Full roll-out in place • Key policies endorsed and executed upon • Early fruits of sustainable improvements	• Tangible and sustainable benefits across all GLCs • Visible benefits to all stakeholders. e.g - customer, vendors, employees, etc • Large scale strategic and financial changes made • Material changes to Boards	• Several regional champions • Most GLCs performing at par with competitors

FIGURE 1. Phases in GLC Transformation Programme
(Source: Government of Malaysia (2006a))

LITERATURE REVIEW

THE QUALITY OF FINANCIAL REPORTING

There are many factors influencing the quality of reporting across the world (Basu 1997 – U.S.; Ding and Stolowy 2006 – France; Ahmed 2008 – Bangladesh; Ezad and El-Masry 2008 – Egypt). Ball et al. (2003) listed six factors that influence the incentives of the preparer (i.e. managers and auditors) in financial reporting: 1) the system for determining and enforcing accounting standards; 2) the influence of family control, guanxi (personalised network) and banks on the demand for public disclosure; 3) political influence on financial reporting practice; 4) the link between tax and financial reporting; 5) the enforcement mechanisms; and 6) the standards.These incentives influence accountants in their judgment on the recognition and disclosure of certain items and, hence, shape financial reporting in a particular country.

According to Ball et al. (2003), the characteristics of East Asian financial reporting (including Malaysia) show a resemblance to countries predominantly governed by the code law model. In the code law model, the preparers' incentives are mostly influenced by their government's policies and decision making. In addition, most of their companies are managed by family related directors and there is a direct link between the tax and financial

reporting. On average, these countries also experience a low level of enforcement mechanisms, which has caused the preparers' incentive to dominate the financial reporting practices (Saudagaran & Diga 2000). In the case of Malaysia, Ball et al. (2003) found that financial reporting in Malaysia is less conservativeand exhibits no greater timeliness in recognising economic losses relative to gains. These characters are similar to countries under the code law model. The analysis also shows that the timeliness of recognising loss recognition is lower compared to gain recognition. These results explain (at least partly) why Malaysia has generally lower levels of public disclosure and liquidity than other common law countries. This study attempts to relate these issues with the involvement of government in the Malaysian business landscape. While there is a spectrum of ways to describe the quality of financial reporting, such as the quality of earnings, accruals, valuation of assets and disclosure, this study makes an attempt to shed some light on the issue of gains or loss recognition timeliness, which has received very little attention in prior studies.

THE TIMELINESS OF ECONOMIC INCOME AND LOSS REPORTING

Timeliness is defined as the extent to which current-period accounting income incorporates current-period economic

income (Ball et al. 2003). While conservatism is interpreted as the extent to which current-period accounting income asymmetrically incorporates economic losses, relative to economic gains (Basu 1997). Thus, conservatism may result in achieving timeliness in reporting economic losses but not gains. Consistent with this, Ding and Stoloway (2006) found that in French companies, good news has a delayed impact on earnings. The results suggest that accountants only allow the effect of good news to gradually affect the earnings measure over some time. Conversely, bad news is reflected rapidly in the earnings.

Basu (1997), and Giner and Rees (2001) explored asymmetric timeliness in the reporting of good and bad news. Differences in the association between current period earnings and both current and prior periodreturns might exist because of differences in the speed of recognition of bad versus good news. Moreover, Basu (1997) argued that the long process of recognition of good news drives persistence in earnings series in contrast to the conservative reporting of bad news.

The study by Eriotis et al. (2009), on the effect of asymmetric timeliness in the reporting of good and bad news on the properties of profitabilityin the Athens Stock Exchange, also suggests that there are differencesbetween the speed of recognition of good and bad news. Ezat and El-Masry (2008) found a significant relationship between the timeliness of Corporate Internet Reporting and firm size, type of industry, liquidity, ownership structure, board composition and board size. However thus far, there is no formal test on the timeliness of reporting good and bad news in GLCs as the greater government influence in the corporate governance mechanisms would create different incentives and affect the timeliness of income. As the emphasis of the government covers financial and non financial parameters, the managers may have lower incentive to manage reported earnings so long as the managers can use social contributions that the companies have made to justify the position of the companies.

In the context of GLCs, Ang and Ding (2006) studied the governance structure of GLCs in Singapore, focussing on ownership or the control structure. They found that Singaporean GLCs have higher valuation and better corporate governance than Non-GLCs. Similar to other research, as indicated earlier, Ang and Ding's (2006) study also used cross sectional GLCs data to examine the effect of governance on the valuation of GLCs. To date, it is unclear how the overall transformation of the GLCs programme affects the quality of information provided to the users. We expect that before the transformation programme there was a lack of appropriate monitoring mechanisms in place with respect to monitoring the financial health of the company. If appropriate governance mechanisms are in place, the risk of failure could be avoided since the risk management function of the board could detect any initial problems in the company and measures to address the problems could be taken earlier. Similarly, if appropriate measurement of income and disclosures are made, investors and analysts with the necessary skills could detect the problems that exist in the company before actual failure occurs. Overall, given the background of GLCs in Malaysia, we expect that the timeliness of accounting gains and losses was lower (higher) in GLCs compared to Non-GLCs before (after) the government transformation programme.

RESEARCH METHODOLOGY

The overall sample comprises 4,234 company-year observations. These are listed companies on Bursa Malaysia (previously known as Kuala Lumpur Stock Exchange) between 2004 and 2009. According to a Government gazette related to GLCs, released on 29th January 2004, there were 57 GLCs (whereby 39 companies are listed companies and 18 are GLC subsidiary companies).

All data (which are all financial data, as listed in Equation 1) are gathered and pooled from the *Datastream* database. Since the transformation manual was published in July 2005, we use this as a cut-off point for the government transformation programme to be effective. For analysis comparison of the transformation programme, we denote the period 2004 to 2005, as before the transformation programme, and 2007 to 2009, as after the transformation programme. It is also acknowledged that the effect of the transformation programme could be seen a few years after the issuance of the circular. Year 2006 is eliminated to account for the transformation transition period.

From 4,234 company-years for the period of 2004 to 2009, we trimmed the top and bottom 1% of sorted observations according to each variable to deal with outliers. Finally, 4,074 company-years data qualify for further analysis. Of this, only 139 company-years are related to GLCs in the sample period. Table 1 shows the breakdown of the sample according to years and industry. It appears from the table that there is no systematic distribution pattern across years and industry, and all industries are fairly represented. This is because we take the data of all of the companies listed on Bursa Malaysia and make categories of GLC and Non-GLC observations. The Non-GLCs are used as comparisons.

According to Ball et al. (2003), the yearly changes in market value of equity (adjusted for current period dividends and capital transactions with shareholders) is used to proxy for economic income. Accounting income is measured by yearly change in book value of equity (adjusted for dividends and capital transactions with shareholders) assuming "clean surplus" accounting. For each year, we estimate a linear regression of accounting income on change in market value of equity as suggested by Basu (1997) and Ball et al. (2003) for:

1. Overall 2004 to 2009 companies financial report;
2. GLC and Non-GLC companies financial report during that period; and
3. Before (year 2004-2005) and after (year 2006-2007) circular issued for GLC and Non-GLC companies financial report.

TABLE 1. Sample Distribution Across Industry and Year

Panel A

Year	2004	2005	2006	2007	2008	2009	Total
Non GLC	618	673	732	761	800	351	3,935
GLC	23	24	25	25	28	14	139
Total	641	697	757	786	828	365	4,074

Panel B

Industry	Service	Plantation	Consumer Product	Industrial Product	Real Estate / Construction	Financial Institution	Other	Total
Non GLC	738	402	986	1014	637	78	80	3,935
GLC	49	8	21	20	13	22	6	139
Total	787	410	1007	1034	650	100	86	4,074

We adopted the methodology of Ball et al. (2003) to investigate the issue. The equation for regression is as follows:

$$NI_{it} = \beta_{oj} + \beta_{1j}R_{it} + \beta_{2j}RD_{it} + \beta_{3j}R_{it}RD_{it} + \varepsilon_i \qquad (1)$$

Whereby:
1. The earnings variable NI_t is $NPBT_t/N_iP_{t-1}$, where NPBT is net profit before tax, N is the number of shares and P is share price, for period t.
2. Stock return R_t is the change in market share price scaled by prior period share price $(P_t-P_{t-1})/P_{t-1}$, including dividends over the company's fiscal year. This represents the economic income.
3. An observation with negative return is given a value of 1 (and 0 otherwise), which is denoted by a dummy variable, RD_{it}.

The equation is used to run using pooled cross section (across firms) and time-series (fiscal years) data. The sensitivity of accounting income to positive changes in market values of equity is represented by β_{1j}. This coefficient is our proxy for economic gains. The incremental sensitivity of accounting income to negative changes in market values of equity is measured by β_{3j}. This coefficient will represent the proxy for economic losses. The total sensitivity of income to decreases in market value is $(\beta_{1j} + \beta_{3j})$ (Ball et al. 2003).

RESULTS AND DISCUSSION

Overall, from Table 2, we can see that GLCs are more volatile than Non-GLCs in return and accounting income. The table shows that the data for both categories of company (GLCs and non-GLCs) are generally skewed (mean > median). This gives an indication that the data may not be normally distributed, which may lead to non-normality in the residuals from the regression. To get an unbiased result we include a test for non-normality of the residuals. It also appears from the table that the mean and median for the returns reported here are different from those previously reported in Ball et al. (2003). This is because Ball et al. (2003) used the mean adjusted returns to control for the influence of exogenous macroeconomic factors on returns. In this study, the use of a single country data eliminated such an effect.

Table 2 also indicates that there are some variations in the means and medians of returns and net income across years. These variations demand additional analysis to be done to examine whether other factors such as economic wide effect may have affected our results. A non-parametric test using the Mann Whitney U test (Non-parametric test is used in light of the non-normal distribution discussed earlier) shows that the overall medians of Return and NI are significantly larger in GLCs compared to Non-GLCs (Z=2.219, p =0.026). This test suggests that the basic component and perhaps the behaviour of these two proxies could be different in these two categories of companies.

Table 3 explains the contemporaneous association between earnings and returns. We have investigated the residuals and the plots suggest that the distribution of residuals is satisfactorily normal. The results reveal that Adjusted R^2 improves as outliers were deleted from the data (from 2.8% to 6.9%). These values of Adjusted R^2 are comparable to Ball et al. (2003) who found that the Adjusted R^2 value for Malaysia is around 9%. Results of the analysis presented in the table also show that the Adjusted R^2s (i.e. variance explained) are in general, higher in GLCs than Non-GLCs for both pre (2004-2005) and post (2007-2009) transformation programme. This implies that, in general, the earnings timeliness is higher in GLCs than in Non-GLCs. The result suggests that the timeliness of earnings in GLCs was better than Non-GLCs even before the transformation programme. It also appears that from the perspective of earnings timeliness, the transformation programme has not played a significant role. In contrast to our expectation, the variance explained is higher before compared with after the transformation programme. However, the reduction of Adjusted R^2 is also experienced

TABLE 2. Sample Characteristics: Descriptive Statistics

YEAR		Non-GLC		GLC		Total	
		Return	NI	Return	NI	Return	NI
2004	N	618	618	23	23	641	641
	Mean	0.078	0.037	0.121	0.054	0.079	0.038
	Median	0.005	0.056	0.076	0.080	0.006	0.057
	Std. Deviation	0.467	0.165	0.285	0.173	0.461	0.165
2005	N	673	673	24	24	697	697
	Mean	-0.219	0.022	-0.082	0.015	-0.214	0.022
	Median	-0.243	0.055	-0.071	0.076	-0.235	0.056
	Std. Deviation	0.312	0.198	0.221	0.180	0.310	0.197
2006	N	732	732	25	25	757	757
	Mean	0.133	0.024	0.243	0.017	0.137	0.024
	Median	0.040	0.074	0.119	0.087	0.047	0.075
	Std. Deviation	0.445	0.238	0.413	0.308	0.444	0.240
2007	N	751	761	25	25	786	786
	Mean	0.240	0.057	0.388	0.129	0.245	0.059
	Median	0.114	0.080	0.167	0.107	0.121	0.080
	Std. Deviation	0.538	0.221	0.599	0.138	0.541	0.219
2008	N	800	800	28	28	828	828
	Mean	-0.277	0.020	-0.315	0.056	-0.278	0.031
	Median	-0.311	0.057	-0.368	0.062	-0.313	0.075
	Std. Deviation	0.321	0.25	0.262	0.134	0.139	0.265
2009	N	351	351	14	14	365	365
	Mean	0.139	0.028	0.293	0.109	0.145	0.031
	Median	0.033	0.074	0.173	0.098	0.036	0.075
	Std. Deviation	0.486	0.269	0.463	0.080	0.485	0.265
Total	N	3,935	3,935	139	139	4,074	4,074
	Mean	0.002	0.032	0.085	0.060	0.005	0.033
	Median	-0.077	0.063	0.060	0.080	-0.074	0.064
	Std. Deviation	0.476	0.215	0.458	0.190	0.475	0.214

Note: NI_t is X_t/N_tP_{t-1}, where X is net income before extraordinary items, N is adjusted number of shares and P is share price. Stock return R_t is the change in share price, scaled by prior period share price. Negative return is denoted by a dummy variable, RD_{it}.

TABLE 3. Contemporaneous Association Between Earnings and Returns

	Overall (1)	Trimmed 1% Outlier (2)	GLC Only (3)	GLC (2004 & 2005) (4)	GLC (2007 - 2009) (5)	Non GLC (2004-2005) (6)	Non GLC (2007-2009) (7)
β_{oj}	0.032*** (3.405)	0.032*** (9.940)	0.091*** (3.541)	0.074*** (1.956)	0.090*** (3.355)	0.058*** (5.321)	0.058*** (5.409)
β_{1j}	0.016*** (11.175)	0.119*** (17.432)	0.064 (1.364)	0.188 (1.398)	0.089** (2.299)	0.076*** (3.806)	0.085*** (5.229)
β_{2j}			-0.022 (-0.474)	0.012 (0.196)	0.025 (0.540)	0.031** (2.017)	-0.002 (-0.153)
β_{3j}			0.238* (1.862)	0.528** (2.177)	0.093 (0.881)	0.220*** (5.885)	0.110*** (3.048)
Adj R^2	0.028	0.069	0.139	0.393	0.154	0.114	0.081
F Stat.	124.885***	303.866***	8.440***	10.929***	4.999***	56.516***	56.776***
N	4,234	4,074	139	47	67	1,291	1,912

$$NI_{it}=\beta_{oj}+\beta_{1j}R_{it}+\beta_{2j}RD_{it}+\beta_{3j}R_{it}RD_{it}+\varepsilon_{it} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\text{Equation (1)}$$

Note: NI_t is X_t/N_tP_{t-1}, where X is net income before extraordinary items, N is adjusted number of shares and P is share price. Stock return R_t is the change in share price, scaled by prior period share price. Negative return is denoted by a dummy variable, RD_{it}. Figures in parentheses are t-statistics. *, **, *** denotes significant at 0.10, 0.05, 0.01 levels, respectively.

by the Non-GLCs (pre 2006 is 0.114 while post 2006 is 0.081). It should be noted that these Non-GLCs do not have a formal transformation programme as in the GLCs (though these Non-GLCs may have their own transformation programme individually applied during the observation years). This suggests that the reduction in Adjusted R^2 could also be attributed to economic and market wide effects such as the implementation of new IFRSs, which came into effect in 2006. The analysis also shows that companies recognized their losses in a timely manner for both the 2006 to 2007 and 2004 to 2005 periods.

However, when we look into the specific coefficient of β_{1j} and β_{3j} which determine different timeliness levels for recognizing gains and losses, a different story emerges. Both coefficients are significant for Non-GLCs indicating that the

companies are timely in recognizing economic gains and losses although the strengths are at different levels. However, for the GLCs, the coefficient β_{3j} value equals 0.238, whichis mildly significant before the transformation programme (t=1.862), but not significant after the transformation programme. This indicates that the incremental economic losses sensitivity is more before the transformation programme compared to periods after the transformation programme in GLCs. Conversely, the coefficient β_{1j}, which is not significant before the transformation programme (coefficient=0.188, t-statistic=1.398), becomes significant after the transformation programme (coefficient=0.089, t-statistic=2.299). This result implies that economic gains recognition improves post year 2006. However, when we take a closer look at the results in Non-GLCs a
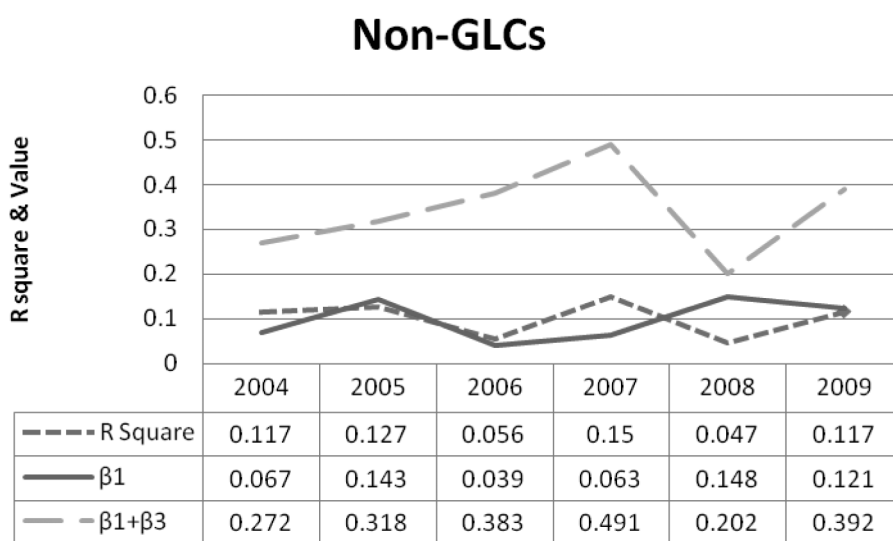
Non-GLCs

	2004	2005	2006	2007	2008	2009
R Square	0.117	0.127	0.056	0.15	0.047	0.117
β1	0.067	0.143	0.039	0.063	0.148	0.121
β1+β3	0.272	0.318	0.383	0.491	0.202	0.392

FIGURE 2. R Square and Coefficients Trend (GLC)

GLCs

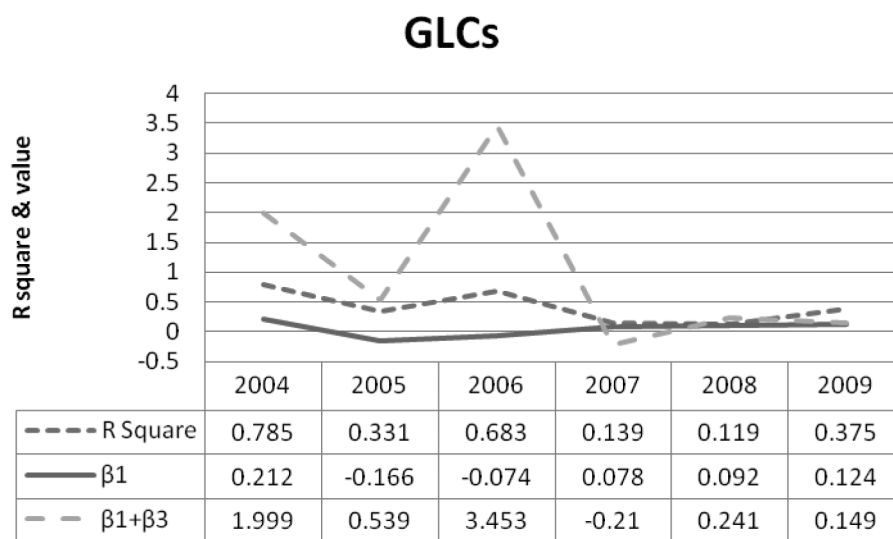|	2004	2005	2006	2007	2008	2009
R Square	0.785	0.331	0.683	0.139	0.119	0.375
β1	0.212	-0.166	-0.074	0.078	0.092	0.124
β1+β3	1.999	0.539	3.453	-0.21	0.241	0.149

FIGURE 3. R Square and Coefficients Trend (Non-GLC)

similar pattern occurs. The coefficient value, as well as the t-statistics, improves after year 2006. These results may also imply that the improvement of economic gains recognition may be partly due to the implementation of the new IFRS standards in Malaysia. The use of more fair values in financial statements may improve economic gains recognition.

We also plot the sensitivity of accounting income to positive returns (β_{1j}) and negative returns ($\beta_{1j} + \beta_{3j}$). From the graph, it appears that there is significant volatility with respect to β_{3j} values across years for both groups that are translated into variations in $\beta_{1j} + \beta_{3j}$ values. This shows the incremental economic losses sensitivity is not stable and subject to significant managerial discretion. Investigation into the incentives and specific forms of decisions related to economic losses recognition is subject to future research. As a limitation of the study, investigation of the actual improvement in GLCs governance post transformation era was not made in this study.

CONCLUSION

Overall, this study further investigates the quality of financial statements by focusing on the quality of financial reporting in Government Linked Companies (GLCs) incorporated in Malaysia for the period of 2004 to 2009. We also look at the trend and pattern of the quality of financial reporting in pre (2004 to 2005) and post (2007 to 2009) transformation programme. Since the transformation programme aims to improve governance in GLCs, any improved reporting practices can be indirectly linked to improved governance in GLCs.

The results suggest that earnings timeliness is higher in GLCs than in Non-GLCs and the timeliness of earnings in GLCs is better than Non-GLCs, even before the transformation programme. On the effect of the transformation programme on GLCs, we found that incremental economic losses sensitivity is more before the transformation programme compared to periods after the transformation programme. We also found that economic gains recognition improves post year 2006. Taking a closer look at this issue, it appears that there is an overall decline in the level of earnings timeliness (in both GLC and Non-GLC groups), which could be attributed to the effect of the new IFRS implementation drive in Malaysia. Yearly analysis reveals that there is non-stability in the effect of incremental economic losses sensitivity, which requires specific investigation into the incentives and specific forms of decision in the future.

It appears that the government transformation programme does not have a significant effect on the quality of reporting in GLCs. A guideline in strengthening financial management and reporting to achieve quality reporting in GLCs is needed. This is very important for the good functioning of the capital market because GLCs contribute about one-third of the total market capitalisation.

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