CHAPTER 2

LITERATURE REVIEW.

2.1 Introduction.

This chapter consists of various kinds of research associated with timeliness of annual reporting. Generally there are two main types of studies on timeliness. The first type is on the relationship of timely reporting and the impact on the stock price for example Chamber and Penman (1984). The second type mainly focuses on the reporting lag and the factors that influence them for example Dyer and Hugh (1975). This paper focuses on the second type of the literature. This is because it is more relevant to this study. The literature will be presented in chronological order. At the end of the chapter, this paper will present the theoretical framework and develop a testable hypothesis.

2.2 Prior research and the findings.

The study on the impact of corporate behavior toward timeliness was pioneered by Dyer and Mc Hugh (1975). He studied one hundred and twenty companies that were listed on the Sydney Stock Exchange which cover a period from 1965 to 1971. The variables were corporate size, financial year end and profitability. Dyer and Mc Hugh in their study divided the reporting lags into three primary lags which were as follows (refer illustration 1 also):
1) Preliminary lag that is the open interval of numbers of days from year end to the receipt of the preliminary final statement by the Sydney Stock Exchange.

2) Auditor signature lag that is the open interval of the number of days from the year end to the date recorded as the opinion signature date.

3) Total lag that is the open interval of the number of days from the year end to the receipt of the published annual report by the Sydney Stock Exchange.

Illustration 1. Three primary lags in reporting as reported in Dyer and Mc Hugh study.

Preliminary lags

Auditors signature lags

Total lags (Preliminary and auditors signature lags)

Number of days

The study used non-parametric test because of the smallness of the sample sizes and also the non-normal distribution and positively skewed. They found that company size and year end closing date were significantly associated with the total lag. Larger firms took less time to report. The rational is they are more in the public eye. Companies with year end closing date is 30th June are generally less timely in relative to other year end closing date. This is because during the peak period auditors took longer time than non-peak period. He also found that the total time lag was increased from 101 days in 1965 to 117 days in 1971. The following studies are mostly extensions of the Dyer and Mc Hugh research.

Coutis (1976) extended the research to the New Zealand Stock Exchange. Using four different corporate attributes used by Dyer and Mc Hugh, he studied the association of the attributes and the reporting delay in New Zealand. The
attributes examined were company age, number of shareholders, no of pages of annual report and industry. He found that none of the attributes examined were significantly associated except for industry where the companies were involved in. He found that fuel and energy and finance type companies tend to be fast reporters while service industries and mining and exploration companies tend to be slow reporters. The average interval of time between Balance Sheet date and Annual General Meeting date in Courtis's study was eighteen weeks.

Gilling (1977) however commented that the production of an audited set of financial statement is a function of both management who prepare the account and the auditors who examine them. Gilling then studied the association between attributes of auditors and auditing lag. He found that leading audit firms work faster than smaller firms and usually scheduled their work according to three categories namely oversea companies, large companies and small companies. The reason for the priorities setting may be due to client pressure (Gilling 1977).

Davies and Whittred (1980) through their extension of Dyer and Mc Hugh research argued that neither of the above approach could provide adequate explanation of corporate reporting process. They stated that the length of a corporation's reporting lag is the outcome of the interaction of between management and auditor. They usually negotiate regarding the type of audit report to be rendered in any given circumstances. In their study, Davies and Whittred used the same sample of Dyer and Mc Hugh's study but using the most recent data that is 1972-1977. Davies and Whittred also added few variables. There were the auditing firms, changes in auditing firm and the presence of extraordinary items. The result of their statistical analysis showed that the type of audit firm and the presence of ordinary items were related to the reporting behavior.
The studies on the timeliness of annual reporting were extended to North America by Garsomske (1981). The variables used were company size, listing status, auditor type, year end period, management attitude and favorableness of reported earnings. Using univariate analysis, he found that there is a statistically significant difference between companies listed on the New York Stock Exchange and American Stock Exchange. The other subsequent studies on US companies have been carried out by Givoly and Palmon (1982). The paper analyzed the relationship between timeliness of annual report, its content and certain company attributes. Givoly and Palmon stated that annual reports contain bad news tend to be delayed. They also found that late earning report appear to convey less new information than earlier report. This study used two hundred ten companies in twenty five industries as a samples. The period of analysis cover fifteen years from 1960 to 1974.

In the comparative study, Frost and Pownall (1994) had compared the timeliness of both domestic and foreign companies listed in US and UK. They found that companies listed in the US are more timely reporters compared to the companies listed in UK. The annual and interim report data shows that compliance is higher in US than UK even though issuers in the US must file more detailed information in their financial reports and the allowed lags for US companies is shorter than UK issuers. Mann-whitney U tests confirm that US companies made timely reporting with shorter lag than UK companies. This is because of the different policies and regulation and enforcement mechanism between two countries.

Another comparative study were done by Courteau and Zeghal (1996). They studied the determinants of reporting delay of 3618 firms from eight countries namely Australia, Canada, France, Germany, Italy, Japan, UK and US. Such comparison may be useful as investing activities is getting global and financial market integrated. They found that there were significant differences across the countries. The differences are because of the company attributes as discussed in previous work and the national factors such as the statutory filing deadline.
According to Couteau and Zeghal filing deadlines vary from 90 days after year end closing date for Canada, Italy, Japan and US to 180 days in France and UK.

A recent study on the timeliness had been extended to the emerging stock market for example Ng and Tai (1994), Abdulla (1996) and Stephen Owusu-Ansah (2000). Stephen Owusu-Ansah in his study on the timeliness of corporate financial reporting in emerging capital market – Zimbabwe Stock Exchange had developed seven hypothesis which involve seven variables which are company size, profitability, gearing, extraordinary and contingent items, year end period, complexity of operation and company age. Based on the result of two stage least regression he found that the preliminary earning is influenced by size, profitability, age and audit reporting lead time. Size was the only factor that was found to influence the release of annual audited accounts. Stephen's study showed that ninety eight percent of the sample (47 listed companies) report within the regulatory period.

2.3 Development of hypothesis

Prior literature had shown that regulation had played an important role in determining the reporting lag. For example a comparative study done by Frost and Pownall (1994) and Courteau and Zegnal (1996) showed countries with different national factors had a significant difference in reporting lags. National factors refer to the regulations and enforcement. In Frost and Pownall (1994) study for instance, they confirmed that US companies made timely reporting with shorter lag than UK companies. This is because US have more stringent policies compared to UK.
Having all the same company attributes with different type of regulation could bring a significant difference in reporting process. Malaysian authorities after the period of financial crisis (1997) had implemented several measures and regulations in order to stabilize the capital market. Timeliness was one of the factors that had been focused by KLSE in order to make the market more efficient and stable. As mentioned by William R Scott the market can never depend on the market forces alone. Therefore regulations and enforcement is needed to ensure the investors are protected.

Those measures are expected to give an impact on the reporting process of the Malaysian companies. The listed companies are expected to take less time in preparing their final accounts to be ready for auditing. This is because the accounts had been prepared on the quarterly basis. According to KLSE requirement the quarterly reporting should be made available to the public within 60 days after the quarterly ending period. Therefore logically, the final accounts are just a compilation of the data that had been prepared. That is why the KLSE provides a provision that the requirement for the annual audited accounts is override if the annual report is ready within 4 months after the closing year end. The quarterly reporting requirement indirectly forced the accounting team in the company to continuously update their accounts timely.

The study on the effect of the quarterly reporting requirement and timeliness do not really attracting much researcher interest. However the findings of comparative studies done by Frost and Pownall (1994) and Courteau and Zeghal (1996) can be implies in this situation. The above study compares different countries which have different national factors. This study on the other hand intends to measure any of the differences in the number of days taken by the listed companies between the period before and after the implementation of the requirement. The study will covers a period of four years (1997, 1998, 1999 and 2000). It attempts to compare the reporting lags between 1997 and 1998 (before the implementation) and year 1999 and 2000 (after implementation).
Please refer illustration 2. The numbers of days in each year are considered as the variables in this study. The impact may not be apparent in year 1999 as the requirement has just been implemented. The real impact should be clearer in the year 2000. Thus it is hypothesized in the alternative form of null hypothesis that is:

H1: There is a significant different in the numbers of days taken by the listed companies between the years in submitting their annual reports.

\[ H_1 = Y_{1997} \neq Y_{1998} \neq Y_{1999} \neq Y_{2000} \]

Variables:
1) \( Y_{1997} \) = Numbers of days in the year 1997
2) \( Y_{1998} \) = Numbers of days in the year 1998
3) \( Y_{1999} \) = Numbers of days in the year 1999
4) \( Y_{2000} \) = Numbers of days in the year 2000

Illustration 2 is to explain the method above:

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<thead>
<tr>
<th>Year</th>
<th>1997</th>
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<td>Implementation of new requirement</td>
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<td></td>
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<td>Period before implementation</td>
<td>Period after implementation</td>
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In the next chapter this paper will discuss the research methodology and the tests to be in the study.