PERSISTENCE AND VALUE RELEVANCE OF COMPONENTS OF RECLASSIFICATION ADJUSTMENT IN OTHER COMPREHENSIVE INCOME

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Abstract. IFRS convergence financial accounting standards require companies in Indonesia to present a comprehensive income statement that includes the presentation of net income, other comprehensive income, and total comprehensive income. And also in 2014, financial accounting standards require reporting of other comprehensive income by including two components, namely: those that will not be reclassified and will be further reclassified to net income. This raises several questions whether reclassification adjustments can increase the usefulness of net income information as an indicator of overall performance. This study aims to investigate two earnings qualities, namely the persistence and value relevance on net income, total comprehensive income and net income without reclassification adjustment components. The research sample is a non-financial company listed in the Indonesia Stock Exchange consisting of 431 companies selected as samples with a period of data collection from 2011 to 2018. There are four hypotheses tested using regression techniques. The results showed several findings, namely net income is more persistent than total comprehensive income; net income is more persistent than net income without reclassification adjustment component; the relevance of net income value is higher than total comprehensive income by using price model and value relevance of net income higher than net income without reclassification adjustments using price model. The results of research on earnings quality in net income, total comprehensive income and net income without reclassification adjustments benefit various parties, such as investors, financial analysts and creditors, prioritizing earnings quality.

Keywords: other comprehensive income; total comprehensive income; persistence; value relevance

1. INTRODUCTION

In 2009, Indonesia became one of the G20 countries committed to adopting International Financial Reporting Standard (IFRS). International Financial Reporting Standard (IFRS) itself is an accounting and reporting standard that applies internationally as a substitute and refinement of the previous standard, namely the IAS issued by International Accounting Standard Boards (IASB). Indonesia adopted and implemented IFRS in 2012 which requires entities to present financial statements containing either income statement, other comprehensive income (OCI) and total comprehensive income (TCI) in the comprehensive income statement for the period beginning on or after January 1, 2011 Accounting standards in Indonesia have experienced various revisions and changes aimed at improving the quality of financial reporting practices.

Definition of other comprehensive income under PSAK 1: Presentation of Financial Statements (Revised 2016) is a change in equity during one period resulting from transactions and other events other than items that cannot be included in the calculation of net income. It is explained that other comprehensive income is classified by nature and grouped as follows: 1) will not be further

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reclassified to net income; and 2) will be further reclassified to profit and loss when certain conditions are met.

Reclassification adjustments or what is often called recycling occurs when other components of comprehensive income are reclassified to profit and loss when the criteria regarding realization and uncertainty are met (Van Cauwenberge & De Beelde, 2007). Reclassification moves an item from another comprehensive income subtotal to another subtotal, namely other income (Rees & Shane, 2012

Black (1993) assesses this research considered important because there are investors who need information about better measurement of company performance, whether net income or total comprehensive income. In addition, in Indonesia alone, research on the nature of net income and total comprehensive income is needed because since 2012 the Dewan Standar Akuntansi Keuangan (DSAK) has a commitment to support the application of financial accounting standards that refer to IFRS, where companies are required to present financial statements according with the provisions listed in the standard such as the presentation of net income and total comprehensive income. With the age of application of IFRS in Indonesia which is classified as young, which is seven years, this research assesses research on the characteristics of net income and total comprehensive income still needs more attention so that this research contributes to analyzing two characteristics (persistence and value relevance) in net income and total comprehensive income in Indonesia.

In Indonesia, other comprehensive income reporting requirements are included by including two components: those that will not be reclassified, and which will be further reclassified to profit and loss in force in 2014 even though they have adopted IFRS since 2012. With a relatively small standard period, the existence of references can reinforce the general conclusion that these standards have little latent function in Indonesia. Other comprehensive income as a whole is still a dirty, so there is another component of comprehensive income that will potentially become cash flow, and some will not. From a theoretical perspective, reclassification adjustments allow consistent articulation between accumulated net income and accumulated net cash flows during the company's operating period. From a practical point of view, analysts and users of financial statements usually use net income as an income proxy in the calculation of earnings per share (EPS), where EPS numbers are widely used for decision making. The reclassification adjustment transaction allows all accumulated transactions of other comprehensive income to be subsequently recognized in net income. Detzen (2016) reveals that reclassification adjustments can maintain net income as a key performance indicator, and when reclassification adjustments are abolished can damage the income concept itself. Thus, the use of net income as a measure of income in EPS calculations can be said to be strengthened because of reclassification adjustment transactions (Rees and Shane, 2012). Thus, it can be concluded that reclassification adjustments can increase the usefulness of net income information as an overall performance indicator and are useful for users because investors are interested in earnings information which can potentially be a cash flow. However, this research looks at the lack of references regarding the benefits of the reclassification adjustment component in comprehensive income in Indonesia so that this research assesses the adjustment of reclassification of other comprehensive income to profit and loss to be an important issue that requires further research.

This research examines the characteristics of net income and total comprehensive income, namely the persistence and relevance of the value of non-financial companies listed on the Indonesia Stock Exchange Period 2011-2019. The previous research has shown that net income is more persistence and has more value relevance than total comprehensive income (Kabir & Laswad, 2011). Comprehensive income has value relevance as the market reacts to announced information in the form of abnormal return

2. THEORETICAL FRAMEWORK AND DEVELOPMENT OF HYPOTHESES

2.1. Literature Review

2.1.1 Reclassification Adjustment Other Comprehensive Income

PSAK 1 (Revised 2016) classifies other comprehensive income items into two, which can be reclassified to net income (recycling) and cannot be reclassified to net income (non-recycling). Recycling or other reclassification adjustments of comprehensive income is defined by the International Accounting Standard Board as the amount reclassified into net income in the current period where the previous period is recognized as other comprehensive income. Another component of comprehensive income released from investment risk in the current period must be reduced and added to the sub-total net income to reconcile net income.

Tarca et al., (2008) describe conditions that must be fulfilled when there is a reclassification adjustment transaction, namely when assets are sold where changes in the previous fair value are recognized directly in equity and the fair value gains obtained at the sale of assets. Other comprehensive income items that can be reclassified to net income are gains and losses from realized available for sale, deferred gains and losses from hedge cash flows, and gains and losses from adjusting foreign currency transactions. These items do not reflect the company's performance because the transaction is not realized in net income. When the potential net income is realized, the same amount of the change is subtracted from the other sub-total comprehensive income and added to the sub-total net income.

The potential for reclassification adjustments in the usefulness of income information has been investigated by previous researchers such as Rees & Shane (2012) who argue that users of financial statements find it difficult to distinguish between realized and unrealized gains and losses if the reclassification adjustment is eliminated or total comprehensive income replaces net income as a key performance measure for the company. One reclassification adjustment item that is available for sale that has been reclassified to net income is believed to contribute to the ability to predict better bank performance in the future (Dong, Ryan, & Zhang, 2014). However, Frendy & Semba (2017) oppose the statement from Accounting Standard Board Japan that adjustments to other comprehensive income reclassifications can improve general information usability characteristics of net income. In his research found that the disclosure of reclassification adjustment information by itself does not increase the relevance of values and capabilities in predicting net income and operational cash flow in the future. In addition, the inclusion of reclassification adjustment items in net income is believed to reduce the persistence of net income due to the temporary nature of realized comprehensive income reclassification.

2.1.2 Persistence

The definition of earnings persistence according to Francis, Olsson, & Schipper (2006) is a measure of earnings quality based on the view that a more sustainable profit is profit that has better quality. Earnings persistence shows the company's ability to maintain profits over time. Earnings persistence can be seen from the current year's earnings innovation that is associated with changes in stock prices (Scott, 2009). The more permanent changes in earnings over time, the higher the earnings response coefficient that shows good profit quality.

The quality of earnings from a company is often associated with earnings persistence, because earnings persistence is a component of the qualitative characteristics of relevance, namely predictive value (Jonas & Blanchet, 2000). Lipe (1986) shows a variation in the level of persistence in income due to the existence of different income components. In his research,

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Dechow, Schrand, & Ge (2010) argued that the profit of a company can be said to be better if it has a persistent profit and is not easy to change.

Total comprehensive incomewhich is a combination of net income and other comprehensive income has a more volatile nature. This is because in other comprehensive income combining unrealized gains and losses, uncontrolled market and market volatility will make items gain and loss temporarily. Other comprehensive income itself has components such as changes in revaluation surplus, actuarial gains and losses on defined benefit programs, profit and loss arising from the translation of foreign financial statements, profit and loss from remeasuring financial assets categorized as available for sale, and effective portion from profit and loss on hedging instruments in cash flows. Thus, Barth et al. (1995) concluded that comprehensive income is more volatile than net income.

2.1.3 Value Relevance

The main role of financial statements is to summarize business transactions and other events. Nillson (2003) assumes that financial statements can allow investors to assess companies, so investors need financial information that is relevant to the real situation. Francis & Schipper (1999) measure the relevance of the value of financial statement information with its ability to capture or summarize information, regardless of its source, that affects the value of shares.

Barth, Beaven, & Landsman (2001) emphasize that testing value relevance is a form of testing to operationalize the relevant criteria and reliability contained in the conceptual framework prepared by the Financial Accounting Standards Board. Both criteria serve as a basis for choosing among existing accounting alternatives. Accounting information is stated to have value relevance if it can make a difference in user decisions. In Barth's (2001) study, the relevance of value in accounting information is relevant if the information can reflect information that is relevant to investors and used in assessing the company and measured reliably, can be reflected in the stock price. Relevant information will make a difference to the user's decision. Ahmar & Yudiman (2017) concluded that the company realizes that other comprehensive income is a component that cannot be separated and is considered important in the presentation of financial statements and can increase the value relevance of financial statements.

2.2 Hypotheses Development

In a study conducted by Penman (2002), it was stated that investors as users of financial statements prefer to assess the performance of companies with more persistent income because they expect that the income that has occurred will be repeated again. Barth et al., (1995) state that total comprehensive income contains items that have not been realized so that it concludes that other comprehensive totals are more volatile than net income. In addition, Elliot et al. (1996) shows that this causes investors to assess net income as more persistent than other total income. Based on the theory and research of Barth et al., (1995), Elliot et al., (1996), and Kabir & Laswad (2011) which show the same results, the hypothesis proposed is:

H1a: Net income is more persistent than total comprehensive income

A profit measure has a low persistence if earnings information is irrelevant to predict earnings for the following year (Ohlson, 1999). Income persistence measures the ability of income to predict the future value itself (Dechow & Schrand, 2004). Higher persistence increases the usefulness of information on net income by giving more accurate predictions about the value of its future. The following hypothesis is proposed based on ASBJ's opinion on aggregate net income or that has a

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reclassification adjustment component in it can improve the benefits of information in terms of persistence as follows:

H1b: Net income with a reclassification adjustment component is more persistent than the net income component without the reclassified adjustment component.

The high quality of accounting information is indicated by the existence of a strong relationship between price or stock return and profit and the book value of equity because both accounting information reflects the economic conditions of the company (Barth, Landsman, & Lang, 2008). The main component of total comprehensive income is net income and other comprehensive income (OCI). Net income is considered by investors as the main indicator in assessing company performance and continues to be the main information in financial regulation so far. For managers, net income is better able to measure the company's operating performance better than total comprehensive income because disclosure of other comprehensive income after net income in the same report can cause misinterpretations of the results of the company's operations (Biddle & Choi, 2006). This is because total comprehensive income includes more temporary items than net income, so that the earnings response coefficient of total comprehensive income tends to be smaller than net income (Kothari and Zimmerman, 1995). Previous studies conducted by Dhaliwal, Subramanyam, and Trezevant (1999), and Devalle and Magarini (2010) indicate that the relevance of total comprehensive income is not higher than net income. Thus, the hypothesis regarding value relevance in this research is formulated as follows:

H2a: The relevance of the value of net income is higher than total comprehensive income.

Understanding the usefulness of relative information between different income measures is important when an analyst or investor wants to directly compare and summarize the performance of different companies using a single income measure. Net income is the main indicator in assessing company performance and continues as the main information in financial regulation where net income includes reclassification adjustments of items that are on the OCI before they are realized. So that eliminating the reclassification adjustment component can reduce the value relevance and the role of net income itself as the main indicator in assessing company performance. Therefore, this hypothesis examines ASBJ's opinion on the component of other comprehensive income that can be reclassified to profit and loss can provide the benefits of additional information for users of financial statements in the perspective of value relevance as follows:

H2b: The value relevance of net income containing the reclassification adjustment component is higher than the net income component without the reclassified adjustment component.

3. RESEARCH METHODOLOGY

3.1. Data and Sample

The population in this study are all companies listed on the Indonesia Stock Exchange (IDX) in the period 2011-2018. The sample criteria used are: (1) non-financial companies listed on the Indonesia Stock Exchange in 2011-2018; (2) Companies with financial report ends on December 31st. (3) Have information or data available for the research model. The data are obtained from IDX publications and Datastream. The estimation method used is OLS (Ordinary Least Squares).

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3.2 Research Model

Following the previous research, Kabir & Laswad (2011), the model for testing hypotheses 1a and 1b regarding the persistence of variables was formulated as follows:

$$NI_{t+1} = \alpha + \beta\, NI_t + \varepsilon \qquad (1)$$

$$TCI_{t+1} = \alpha + \beta\, TCI_t + \varepsilon \qquad (2)$$

$$NINRC_{t+1} = \alpha + \beta\, NINRC_t + \varepsilon \qquad (3)$$

where NI is net income, TCI is total comprehensive income, and NINRC is net income without reclassification adjustments. Based on Dechow (1994) and Barth et al., (1995), all variables in the model are divided by the number of weighted average shares to reduce the effect of heteroscedasticity. This research uses NI, TCI, NIRC and NINRC 2011 to predict NI, TCI and OCIR 2012 and later years until 2018. This model shows that hypothesis 1a is accepted when the coefficient, R2, and t-stat values in model 1 are higher than with model 2. While the testing of hypothesis 1b is accepted when the coefficient, R2, and t-stat in model 1 are greater than model 3.

This research also evaluates the value relevance of income following a study conducted by Dhaliwal et al. (1999), using a price model. That way, this research uses the following model to test hypotheses 2a and 2b

$$P_t = \alpha + \beta_1\, BV_t + \beta_2\, NI_t + \varepsilon_t \qquad (4)$$

$$P_t = \alpha + \beta_1\, BV_t + \beta_2\, TCI_t + \varepsilon_t \qquad (5)$$

$$P_t = \alpha + \beta_1\, BV_t + \beta_2\, NINRC_t + \varepsilon_t \qquad (6)$$

where Pt is the price per share at the end of the fiscal year, BVt is the book value of equity at the end of the fiscal year, NIt is the net income available to ordinary shareholders; TCIt is the total comprehensive income available to ordinary shareholders; and NINRCt is net income without reclassification adjustments available to ordinary shareholders. The financial statement variables are divided by the sum of accumulated average during the fiscal year. Following previous research (Dechow, 1994), a model that has a higher R2 value will be taken to explain stock returns and better prices. In addition, this research also follows the research of Kabir & Laswad (2011) who tested the hypothesis by looking at coefficient values, R2, and t-stat to compare each model. Hypothesis 2a can be accepted when in the price model, model 4 is bigger than model 5. For hypothesis 2b it can be accepted when the coefficient, R2, and t-stat values of model 4 are greater than model 6.

4. RESULTS

4.1 Sample and Descriptive statistics

In this study uses the sample based on the criteria are 433 companies, of which companies were listed on the Indonesia Stock Exchange. The observation period used in this study is from 2011 to 2018.

Table 1. Descriptive Statistics

	Mean	Standard Deviation	Minimum	Maximum
NI (in thousand rupiah)	71,59	112,6	-44,66	324,25
TCI (in thousand rupiah)	62,61	96,05	-36,99	275,88
NINRC (in thousand rupiah)	71,03	112,3	-45,75	322,94
P	1.088,32	1.281,45	82	4.050
BV (in thousand rupiah)	589,72	580,63	56,49	1.840,31

4.2 Hypothesis Testing Results

The result of model regression in table 2 shows that the model is statistically significant as shown by probability Prob>F of 0.0000.

Table 2. Regression Test Results

Variabel dependen	Hipotesis	Model					
		1	2	3	4	5	6
		NI_{t+1}	TCI_{t+1}	$NINRC_{t+1}$	P		
NI_t	1a, 1b, 2a, 2b	0,362***			1,921***		
TCI_t	1a,2a		0,236***			0,695**	
$NINRC_t$	1b,2b			0,358***			1,914***
BV_t	2a,2b				0,419***	0,475***	0,420***
Intercept		0,00	0,00	0,00	0,00	0,00	0,00
N Observasi		2.473	2.473	2.473	2.551	2.551	2.551
Prob>F		0,00	0,00	0,00	0,00	0,00	0,00
R-squared		0,649	0,419	0,645	0,5905	0,5034	0,5903

*** significant at 99% confidence level

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5. DİSCUSSİON

The results of this study are consistent with previous research on the persistence and value relevance of net income and the comprehensive income (Chambers et al., 2007; Biddle and Choi, 2006). Based on the summary of the results of the regression test result shows that the value of the persistence coefficient in model 1 is closer to number 1 compared to model 2. In addition, the value of R2 model 1 is greater than model 2. Both models are significant at less than 1 percent. Thus, net income has the potential to be more persistent than total comprehensive income where net income has the expected revised profit in the future (expected future earnings) which is implied by better current year's profit innovation. Variation in the level of persistence in income due to the existence of different income components. So that net income has better persistence because the number is not easy to change compared to the total comprehensive income that has an uncertain number. This is in line with the research from Kabir & Laswad (2011) which found that net income has more persistent potential than total comprehensive income.

Regression test result shows that the regression estimation of the net profit coefficient is closer to 1 than the coefficient of net income without reclassification adjustments. Both coefficients are also significantly below 1 percent. The test results of statistical significance show that net income without reclassification adjustment has a persistence that is higher than net income which is sufficiently supportive to accept hypothesis 1b and supports the ASBJ argument which states that there is an increase in information benefits in net income that has components of reclassification adjustments from a persistence perspective. This is because the reclassification adjustment allows consistent articulation between the accumulation of net income, thus allowing the company to have income that is more persistent in the hope that the income that has already occurred will be repeated again. However, this result is not consistent with the study by Frendy & Hu (2017) which results in a higher persistent value in net income without reclassification adjustments to companies in Japan.

The regression results using stock prices shows that the relevance of the value of net income is higher than other comprehensive income where the regression coefficient and R2 and t-stat in model 4 are greater than model 5. This is because total comprehensive incomereports more temporary items in calculating income than net income (Kothari & Zimmerman, 1995). Investors place less value on items that do not repeat than earnings before items that do not repeat. Thus, net income is considered more beneficial for investors who need financial information that is relevant to the real situation. This result also supports Ahmar et al. (2017) who stated that the company realizes that other comprehensive income is an inseparable component and is considered important in the presentation of financial statements and can increase the value relevance of financial statements.

The results of this research are able to prove ASBJ's opinion that recycling can provide additional information benefits for users of financial statements other than non-recycling (Japanese Accounting Standards Board, 2015b). Statistically, this is because the regression coefficient in model 4 is greater than the regression coefficient of model 6. This result is also supported because the value of R2 and t-stat in model 4 is greater than that of model 6. Thus, we can conclude that value relevance Net income has a higher value relevance than net income without reclassification adjustments to non-financial companies and these findings indicate that non-financial company investors consider disclosure of net profit information without reclassification adjustments as the value of relevant information

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6.CONCLUSIONS

The purpose of this study is to examine two earnings qualities, namely the persistence and relevance of values on net income, net income without reclassification adjustments and total comprehensive income. In this research, the sample used is a non-financial company during the period 2011 - 2018.

Based on the results of tests that have been conducted, this research gets a number of conclusions, namely: 1) net income is more persistent than total comprehensive income; 2) In this study also found the results that net income with a component of reclassification adjustment is more persistent than the net profit component without the reclassification adjustment component; 3) In measuring the relevance of the value of net income and total other comprehensive income, a price model approach is used. The result obtained is that net income has a higher value relevance than total comprehensive income. 4) In measuring the relevance of the value of net income containing the component of reclassification adjustment and net income without the reclassification adjustment component, a price model approach is also used. The results obtained are that the relevance of the value of net income containing the reclassification adjustment component is higher than the net income component without the reclassified adjustment component.

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