BUSINESS INNOVATION AND DEVELOPMENT IN EMERGING ECONOMIES

Edited by
Irwan Trinugroho and Evan Lau

CRC Press
Taylor & Francis Group

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Taylor & Francis
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Comparing properties of net income and total comprehensive income: A study on manufacturing industry in Indonesia

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ABSTRACT: The purpose of this research is to acquire empirical evidence of the benefit of PSAK No. 1 (2009) implementation by testing whether the properties of total comprehensive income are better than those of net income. Four properties of net income and of total comprehensive income were compared. This research also investigated whether the value relevance of total comprehensive income depends on location where the users can obtain this information.

Stock return was measured with average daily stock returns over the fiscal year subtracted with market return. A dummy variable was applied to determine companies that report Other Comprehensive Income (OCI) in their equity statement or in their comprehensive income statement. For companies with OCI, the dummy variable was used to determine the period before and after the implementation of PSAK No. 1 (2009). It represents a place where the users can obtain information about total comprehensive income. This study used a sample of 122 manufacturing firms listed in the Indonesian Stock Exchange from 2008 to 2014. The analytical tool used to test all hypotheses was ordinary least square.

The result of this research demonstrates that net income is more persistence, less variable, and more have predictive ability than total comprehensive income, yet total comprehensive income has more value relevance than net income. In addition, this research reveals that location of OCI is insignificant for the value relevance of total comprehensive income.

Keywords: Indonesia, persistence, variability, predictive ability, value relevance, net income, total comprehensive income, and other comprehensive income

1 INTRODUCTION

PSAK No. 1 (2009) that adopts IAS No.1 of 2009, effective for fiscal year beginning on 1 January 2011 or after, regulates the presentation of comprehensive income statement. The presentation of comprehensive income statement of a period that covers the net income of such period added or subtracted with the changes in other comprehensive income (OCI) items provides information that aid investors and creditors to comprehend more about transformation in equity interest and a company's ability in generating future cash flow (Casabona, 2014). The distinction of income statement presentation after PSAK is only in the disposition of other comprehensive income presentation, which was previously presented in the statement of changes in equity.

The benefits of comprehensive income can be viewed from two perspectives: investor usefulness and contracting usefulness (Black, 2015). Those benefits have been studied as a response to the establishment of SFAS 130 of 1997, with various research results. Some

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support the appeal for comprehensive income statement presentation, yet some others do not. Those who support the idea claim that clean surplus describing only net income and dividend is internally consistent, less supportive to manipulation, and more suitable with valuation theory. On the other hand, those who do not support such idea state that earnings should be summarized from the influence of transitory to illustrate current operating performance and the manager will exclude items that exceed their capability to control those items (Biddle and Choi, 2006).

Earnings quality is observable from 4 perspectives: persistence, volatility, ability to predict one-year-ahead cash flows from operating activities and net income, and association with contemporaneous stock returns (Dechow and Schrand, 2004). Comprehensive income statement determines which of net income or total comprehensive income (TCI) is more qualified, and whether the location of OCI reporting influences the total comprehensive income in explaining stock return. Kabir and Laswad (2011) have confirmed that net income is more persistent and more capable in explaining stock return than TCI. The variability and predictive ability of both are indifferent. In addition, the location of OCI does not influence the value relevance of TCI. Moreover, they distinguish the location of OCI presentation on the basis of whether the comprehensive income is a single continuous statement of comprehensive income or two separate but consecutive statement. However, nearly all companies in Indonesia report OCI in a single continuous statement of comprehensive income. Therefore, this study aims to retest the research conducted by Kabir and Laswad (2011), yet depending on whether OCI is reported in the statement of changes in equity or in the income statement (comprehensive income) to determine the location of OCI reporting.

Whether the location of OCI presentation about income statement is beneficial becomes a concern for some researchers. Hirst and Hopkins (1998) demonstrate with experiment method that an explicit disclosure of income statement on comprehensive income and its component can effectively improve transparency of earnings management activity and reduce the analyst's valuation judgment. Maines & McDaniel (2000) find out that the participants significantly weigh on their volatility valuation when unrealized gains and losses (URGL) appeared in SFAS 130 comprehensive income, but not in alternative SFAS 130 (URGL reported in changes in equity) and statement of changes in equity SFAS 115. On the contrary, Chambers (2007) confirms otherwise. OCI is valued by investors when it stands on the statement of changes in equity because investors are familiar with the predominant OCI presentation location. While Darsono (2012), who proved that the role of OCI information before the regulation on comprehensive income presentation is effective, verifies that OCI influences company value. Since he acquires OCI information from the statement of changes in equity, his finding then confirms that there is no issue about OCI presentation location.

The experiment by Hirst and Hopkins (1998) divides participants into two groups, namely a group with comprehensive income report (CI) and a group without comprehensive income report (non CI), which that comprehensive income information is presented in the statement of changes in equity. The result points out some differences. Based on that, this research would like to retest the research by Kabir and Laswad (2011) in connection with the location of OCI, because according to the research by Hirst and Hopkins (1998), the result would be different when other comprehensive income is not comprehensively presented together with the income statement. Even in the discussion about the research by Hirst and Hopkins (1998), Lipe (1998) emphasizes that even if another group of participant is added, which is the participant informed with the source of another comprehensive income (CI) out of the income statement, the results is much the same, different from the expected result which processing and judgment would be different from the non CI group. It reveals that CI format apparently has advantages.

Value relevance is the correlation of financial statement numbers with the price or stock return. Many researches on earnings value relevance and its items have been conducted. Lipe (1986) finds that stock return variation of industrial and commercial companies are explained better by earnings component than aggregate earnings. Brown (2001), who compares the quality of earnings by three earning components, namely net income, earning per share from operation, and earning per share before extraordinary item, finds that net

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income has higher earnings quality compared to the other. Jaggi and Zhao (2002), who specifically research the impact of transformation from SFAS 12 into SFAS 115 of 1993 about available-for-sale financial assets reclassification, find that the information of earnings components is more relevant for investment decisions after the implementation of SFAS 115.

The result of the research shows that net income in compliance with SFAS 130 dominates traditional net income (Biddle and Choi, 2006) and total comprehensive income (Bidlle and Choi, 2006; Kabir and Laswad, 2011) in explaining stock return. Chambers, et al. (2007) who specifically demonstrate the benefit of other comprehensive income presentation prove that two components of other comprehensive income, which are foreign currency translation adjustment and unrealized gains and losses from available securities for sale, have higher value relevance than the other components. It appears so for Lin, et al. (2007) as well, who uses samples from various country, that confirms that total other comprehensive income has value relevance beyond net income in many countries, but comprehensive income has less value relevance than the other measurement of income, which are operating income and net income. On the other hand, the researches that do not promote the use of comprehensive income statement are that by Dhaliwal et al. (1999) and Doukakis (2010). Dhaliwal et al. (1999) conclude that comprehensive income is not closely associated with stock return nor predicts cash flow or earnings better than net income. Doukakis (2010), who employed the adoption of IFRS phenomenon, validates that the adoption of IFRS that requires comprehensive income statement presentation does not improve persistence of earnings and its component systematically for future profitability. On the contrary, operating and non-operating income persistence are lower, so is the explanatory power after the adoption of IFRS.

With a variety of confirmation about the use of comprehensive income statement, this research aims to test the use of comprehensive income statement in Indonesia for the regulation on comprehensive income statement reporting has only been effective since 2011. This research highlights the role of comprehensive income statement presentation with the perspective of investors usefulness in describing investors' response. Since there is an OCI component that becomes the distinctive feature of comprehensive income statement presentation compared to the previous version of presentation, this research therefore highlights the role of OCI in differentiating the presentation format.

From the view of efficient market hypothesis, the market reaction will be indifferent since investors are not affected by where the information is presented. They can still utilize the information to make decision. However, based on the argument that a market cannot be as efficient as expected, and low stock price proportion that can be explained by historical net income (Scott, 2015), measurement approach and clean surplus theory justify the significance of a research on investors' reaction to the transformation of this income statement presentation.

It is substantial to compare the earnings quality between net income and total comprehensive income in order to determine which of the two is better to use for company performance assessment (Black, 1993). Furthermore, evidences are currently required to evaluate the implementation of PSAK No. 1 (2009). Based on information that 11 of the 20 companies with the largest market capitalization in the Indonesia Stock Exchange have business in manufacturing industry sector (www.kemenperin.go.id), this research focuses on the manufacturing industry, by testing whether the net income and total comprehensive income have differences in earnings quality and value relevance.

This research used 384 manufacturing firm-year observations to test the persistence, variability, and predictive ability of NI and TCI, and 377 manufacturing firm-year observations were used to test the value relevance of both. Observations were conducted from 2008 to 2014, 3 years prior to the presentation of comprehensive income, and 4 years after. This research validates that NI is more persistent, less variable, and more capable in predicting operating cash flow than TCI, with slight difference. On the other hand, unlike NI, TCI may explain return, yet the location of OCI does not influence the value relevance of the TCI.

2   LITERATURE REVIEW

2.1   *Comprehensive income*

Accounting information serves a purpose of providing information for investors about the company's performance to make business decision and to evaluate managers' performance. Designing and implementing well-combined concept and standard, the role of accounting information for the investors, and evaluating the managers' performance are the fundamental issues of accounting theory.

Scott (2015) explains that in ideal condition, there isn't any fundamental issues of accounting theory. The application of current value based accounting in financial reporting is second best condition. Although the use of current accounting in financial reporting is more realistic, the fundamental issues of accounting theory such as mentioned above will still persist. Current value reflects more about the value in the mean time so that it will be more preferable by the investors. Yet, it can be less preferable because the investors are accustomed to historical cost. Moreover, current accounting includes unrealized gain or losses of assets and debts changes. It can increase income volatility and does not reflect the actual performance of managers, and it should not be used to assess operating performance of managers because unrealized gain or losses is not the result of operating performance.

Current value of assets and debts is more potential than historical cost in drawing investors' attention because current value provides the finest available indication on company performance and future investment return. However, managers might think that unrealized gains and losses from the adjustment of assets' and debts' registered value in the current value does not reflect their actual performance. Accounting standards board immediately mediates conflict of interest between managers and investors by trying to make standards that can accommodate the interest of both sides.

Comprehensive income statement covers all changes in equity of the shareholders except transactions with the shareholders as in stock purchase or repurchase and dividend distribution (Casabona, 2014). Ohlson (1995) states that all changes in asset/debt that are not related to dividend have to go through income statement. So, comprehensive income is the income that covers all changes of asset/debt that are not related to the transactions with the owner (changes from dirty surplus to clean surplus).

PSAK No. 1 of 2009 demands all companies to present earnings in comprehensive income statement that elaborates such component into gross profit, operating income, current earning of the year which is net income before other comprehensive income, other comprehensive income, and comprehensive income. The fundamental change of PSAK No. 1 of 2009, effective from 2011, compared to the previous PSAK is the separation of unrealized gains and losses into the category of other comprehensive income. Other comprehensive income contains: unrealized gains and losses of available-for-sale financial assets (PSAK 55), revaluation surplus of tangible and intangible assets (PSAK 16 and 19), gains and losses of defined benefit plan actuary, gains and losses of foreign exchange rate changes from overseas business operation (PSAK 10), and gains and losses of hedging instrument (PSAK 55).

The first step of the comprehensive income concept implementation was executed through SFAS No. 130, issued by FASB in 1997. SFAS No. 130 is a request from AIMR (Association for Investment and Research) that recommends several changes in financial reporting model. That standard demands companies to report comprehensive income along with its components in a statement with similar eminence to basic financial statement (Hirst and Hopkins, 1998). Initially, comprehensive income statement for a reporting period covers net income, as reported in income statement, added or subtracted with items of other comprehensive income unreported in income statement. In June 2011, FASB issued Accounting Standar Update (ASU) No. 2011–05 that regulates the manner of presentation of entities to report comprehensive income in financial statement. Previous FASB directive through Accounting Standar Codification (ASC) 220–45–8 allowed three options in reporting comprehensive income as follows (Casabona, 2014): 1) the total of comprehensive income of a period, as well as other comprehensive income, can be reported under net income total in a single

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combined statement of income and comprehensive income, 2) in separated comprehensive income statement beginning with net income, and 3) in equity statement of the shareholders. Later on, ASU 2011–05 removed the third option, so these two options remain: a single continuous statement of comprehensive income and two separate but consecutive statement. By a single continuous statement of comprehensive income, entities have to include the component of net income, total of net income, component of other comprehensive income, total of other comprehensive income, and total of comprehensive income. Whereas by two-separated-but-consecutive-statement, entities have to report the components of net income and total of net income in net income statement (which is income statement), that has to be followed up with statement of other comprehensive income covering components of other comprehensive income and total of other comprehensive income, and total of comprehensive income. PSAK No. 1 of 2009 also provides 2 options of comprehensive income statement as in ASU 2011–05, which are single and separated.

2.2 *Value relevance of earnings*

Earnings figure is the main concern in a financial statement. By looking at earnings figure, the financial statement information receivers can view a company's overall performance. Earnings are the function of a company's financial performance, and such function demonstrates the accounting system that converts unobservable financial performance into observable earnings figure (Dechow et al. 2010). Therefore, earnings figures cannot completely describe a company's financial performance. Why can't accounting measuring system completely measure the actual performance of a company? Dechow et al. (2010) present three reasons. First is various models of decision. An accounting system that delivers single earnings figure statement cannot provide relevant financial performance representation for all kinds of decisions. The decision maker board creates trade-off to anticipate the users' needs, and eventually there isn't any single decision makers that acquires the image of performance of the company that is perfectly relevant for decision making. Second is the variation in financial performance measurement. There is no single standard that will measure financial performance perfectly for all kinds of company. As an example, the means of COGS (cost of good sold) measurement depends on when a company recognize its revenue. Different companies go with different basis of recognition. Third is implementation. An accounting system that measures unobservable financial performance construct inherently involves estimation and judgment. It can cause either unintentional or intentional mistake (example: earnings management).

How faithful earnings explain actual financial performance is in fact approached with the earnings quality. Earnings quality is a concept that has no general definition in the literature. Schipper and Vincent (2003) define earnings quality from the decision usefulness perspective, that is how faithful an income explains Hicksian income, including assets' net changes other than transactions with the owner. Ayres (1994) states that earnings quality is related to permanent earnings, which is high quality of earnings that portrays sustainable earnings for a long period of time. Bellovary et al. (2005) defines earnings quality as the ability of the reported income to explain a company's actual earning, just like the ability of reported income to predict future earnings. Earnings quality also explains stability, persistence, and low variability of the reported income.

A high quality of earnings figure may deliver the description of current operating performance, a good indicator of future operating performance, and accurate representation of a company's intrinsic value. However, not all earnings figures are created equal due to the dependency of earnings on the compositions of the earnings itself, the stage of the firm's life cycle, the time period, and the industry (Dechow and Sherand, 2004).

Measuring earnings quality is significant because earnings are normally used to arrange compensation or debt agreement. A contract decision based on low quality earning will result in an unexpected welfare transfer. For example, an overstated income that is used as an indicator of manager performance will create an overstated compensation as well. From the

perspective of investment, low earnings quality is unwanted because it is a signal of poor resource allocation, which is inefficient because it distorts potential projects to less profitable projects.

Cornell and Landsman (2003) express that the disagreement on earnings quality is based on more fundamental issue. The key issue that becomes a concern for the regulators and standards board is an efficient capital allocation in a proper capital market function. The precondition for efficient allocation is that market value explains economic value as big as possible. They make two arguments as follows: 1) not even a kind of earnings measurement, including GAAP, satisfyingly represents financial statement information for the purpose of prediction, 2) there is no meaningful criteria to determine whether an earnings measures better than the other components, even for certain companies, than by experience in predicting, and then determining that historical time series is more accurate for predicting.

2.3   Incomplete revelation hypothesis

In the efficient market hypothesis, the form of presentation, either simple or detailed, will not influence the judgment of information users because in an efficient market, the users of information can process all kinds of information quickly and properly. However, the information receiver might react differently toward different kind of information presentation form. The theory that explains such possibility is Incomplete Revelation Hypothesis (Bloomfield, 2002) or IRH. IRH predicts that investors use substantial resource to identify mispriced stock on the basis of public data, where manager tries to increase stock price by hiding bad news in the footnotes, and where the regulators want to prevent such effort, because the information that is difficult to be extracted from the financial statement will not be reflected in the stock price.

IRH distinguishes data from statistics. Data is written text or numbers or the ones saved in the computer file. Whereas statistics is useful facts that are extracted from that data, for example is profit figures or financial ratio. So if the data is extracted into meaningful information, then it becomes statistics. Market players have various tolerance towards the risk and funds related to that risk. Statistics can increase trading desire if the sellers collect it more and if those who collect it have big risk tolerance. Statistics with expensive extraction cost from available public information on the contrary will decrease trading desire, and such statistics will not completely reflected in the stock price. So, EMH predicts that stock market price completely describes all available public information, but IRH is otherwise. IRH predicts that stock market price does not completely describe all available public information.

IRH is also supported by psychological researches that prove that an information will not be used if it is unavailable and not processed immediately. Therefore, Hirst and Hopkins (1998) suggest that the judgment of analyst valuation will be influenced with the clarity of relevant information value disclosure. By applying experiment method, they find that an explicit disclosure of income statement in comprehensive income and its items can improve the transparency of management activity and company profit, and diminish the judgment of analyst valuation.

3   HYPOTHSES

As Kabir and Laswad (2011) once performed, this research also observed 6 hypotheses.

3.1   Persistence and variability of NI and TCI

PSAK No. 1 of 2009 demands all companies to present earnings in comprehensive income statement that elaborates it into gross profit, operating income, current earning of the year which is net income before OCI, OCI, and TCI. OCI comprises unrealized gains and losses from several items, arising from the fair value change of asset or liability.

The unrealized gain or losses from the value changes of assets and debts can increase income volatility (Scott, 2012) because it is transitory and does not describe core earning (Chambers, et al., 2007), which is income earned from the core activity of the company. Income volatility will complicate the investors to make return estimation in assessing investment. Unrealized gain or losses also does not reflect the actual performance of managers, and it should not be used to assess operating performance of managers because unrealized gain or loss is not the result of operating performance. Unrealized gain or loss is influenced by market factors that cannot be controlled by managers and usually is a result of unpredictable random process (Chambers, et al., 2007). Thus, NI may be more persistent compared with TCI, and TCI is more variable than NI.

H1: NI is more persistent than TCI.
H2: The cross-sectional variation of TCI is more than that of NI.

3.2 Predictive ability of NI and TCI

Cash flow of the operating activities is the cash flow utilized and deriving from the primary activities of the company. Unrealized gains and losses from non-primary activities are reported as OCI which is a component of TCI. Therefore, a question is raised concerning which of NI or TCI that is more capable in predicting future cash flows.

Two arguments were then developed. The followers of all-inclusive (clean surplus) believe that TCI contains all changes of economic value resulting from every company activity excluding transactions with the owner. Therefore, investor and creditor will exhaustively comprehend the future prospect of the firm and will be capable to predict future earnings and cash flows in a better manner (Kanagaretnam, 2009). From another point of view, those who promote current operating income (dirty surplus) consider that net income shall define the strength of permanent earnings of a company gained from the primary and repeated company activity that is measured objectively using historical cost based on realization principle. The change of company value resulting from transitory activity may impair its predictive capability.

Kanagaretnam (2009) finds that total comprehensive income correlates more to price and stock return and predicts future cash flows better than net income. Contrarily, Barth et al. (2001) and Dechow and Schrand (2004) confirm that NI predicts future cash flows and NI better than accruals earned from the transitory change of value within TCI.

H3: Predictive ability of NI to predict one-year-ahead CFO is better than TCI.
H4: Predictive ability of NI to predict one-year-ahead NI is better than TCI.

3.3 Value relevance of NI and TCI

Value relevance is the ability of financial statement information to capture or summarize information that influences the company value (Collins et al., 1997; Francis and Schipper, 1999) or stock price (Hellstorm, 2005). High earnings quality provides information about the company's financial performance that is relevant to make specific decision. Income is related to capital market performance. An earnings is high in quality if the correlation between income and stock price or market return is strong. By so, the measurement of earnings value relevance is performed by testing the correlation between earnings and stock price.

Lipe (1986) finds that stock return variation of industrial and commercial companies are better explained by earnings component than aggregate earnings. He find that every component provides information that completes aggregate earnings information, and if the information of earnings component is merged into aggregate earnings figure, then that information will disappear. Different from Lipe (1986), Jaggi and Zhao (2002) specifically conduct a research on the impact of the change of SFAS 12 into SFAS 115 of 1993 that reclassifies the presentation of investment securities on banking corporation. Securities reclassification is expected to decrease management discretion in classifying securities and reduce the gap

of unrealized gains and losses between companies, and further will increase the content of unrealized loss and profit information. The result of their research verifies that the information of earnings component is more relevant for investment decision after the implementation of SFAS 115.

The information content of income and its components can be measured from its correlation with stock return. Investors will react to an information if that information is relevant for them to make decision and it will be reflected in the stock price or stock return. Prior to the implementation of PSAK No. 1 of 2009, companies present income statement consisting of three components: gross profit, operating income, and net income. After the implementation, companies are demanded to present profit in comprehensive income statement that elaborates it into gross profit, operating income, current earning of the year which is net income before other comprehensive income, other comprehensive income, and comprehensive income. With comprehensive income, that has more income components compared to the previous income statement, a question arises about which income is preferred by investors in making decision. In practice, in fundamental analysis, net income still becomes the top priority in making decision on investment. Further, transitory components, or components that are not the core operating activity of the company, become the following consideration. Bidlle and Choi (2006) confirm that net income that conforms with SFAS 130 dominates traditional net income. So do Kabir and Laswad (2011) that prove that net income can explain stock return better than comprehensive income.

From the point of view of investor, income is the amount of profit for the purpose of investment valuation. Investors assess investment based on the opportunity cost, which is market rate of return (Suwardjono, 2005). Thus, from the investors' point of view, income is the internal rate of return of future cash flow that can be earned if those investors invest their assets somewhere else (opportunity cost), meaning if investors invest their assets somewhere else, then that income becomes opportunity cost for them. Income from the point of view of investor is the economic income (real income), which is income in the form of the increase of economic prosperity.

Net income may be more relevant to investors because it is persistent, less varied, and more able to predict return, then net income may be more relevant. However, total comprehensive income may be more relevant than net income because based on IRH information will be used if it is available and processed immediately.

H5: The value relevance of NI differs from TCI.

The fundamental change of PSAK No. 1 of 2009 compared to previous PSAK lies in the presentation of unrealized gains and losses components into other comprehensive income category previously presented in the changes of equity. The location of OCI is evidently capable to improve the transparency of earnings management activities and reduce the analyst's valuation judgement (Hirst and Hopkins, 1998) as well as influence the use of volatility to assess company performance (Maines & McDaniel, 2000). Although all information in an efficient capital market can be processed by the information users, the users of financial statement prefer to utilize the information when such information is clear and presented with simple method (Johson, et al. 1988). It is the foundation to predict that the location of OCI presentation in comprehensive income statement is more beneficial than the presentation in changes of equity statement.

H6: The value relevance of TCI differs depending on its reporting location.

4 METHODOLOGY

4.1 Data and sample

The accounting data for this research was taken from complete financial statement retrieved from www.idx.co.id and the market data was taken from daily stock price acquired from Indonesia Stock Exchange corner. The population of this research is the companies listed in

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Indonesia Stock Exchange (Bursa Efek Indonesia/BEI), and the sample of this research is the manufacturing companies listed in BEI from 2008 to 2014. The sample collection technique applied was purposive sampling method with the criteria that financial statement and market price data were acquired from 2007 to 2015.

4.2 Variables and operational definition of variables

The variables in this research are:

4.2.1 Dependent variable
The dependent variables for this research are one-year-ahead net income (NI_{t+1}), one-year-ahead total comprehensive income (TCI_{t+1}), one-year-ahead cash flow from operation (CFO_{t+1}), stock return (R_t), and stock price (P_t). The value relevance of earnings in this research was measured with stock return, which is the equity return of company t in year t, that was calculated from the gap of stock price of year t and t−1 added with dividend per share of year t, scaled with stock price of year t−1. Since the companies that divided the dividend is only few from the entire sample, then the numbers of dividend is ignored.

4.2.2 Independent variable
The independent variable for this research is net income of the current year, that is net income before other comprehensive income (NI), total comprehensive income (TCI), book value (BV), and the presentation of OCI location (Period), which is the period before the implementation of statement of comprehensive income where OCI is located in the statement of changes in equity and the period after the implementation of comprehensive income reporting where OCI is incorporated within the income statement.

4.3 Models

The first and second model to test the persistence of NI and TCI in the first hypothesis proposed in this research are as follows (Dechow and Schrand, 2004):

$$NI_{it+1} = \alpha_0 + \beta NI_{it} + \varepsilon_{it} \tag{1}$$

$$TCI_{it+1} = \alpha_0 + \beta TCI_{it} + \varepsilon_{it} \tag{2}$$

Notes:
NI_{it} = net income of company i in year t are scaled by the weighted average number of shares.
TCI_{it} = total comprehensive income of company i in year t are scaled by the weighted average number of shares.

From those two models, the coefficient (β) of NI or TCI variable is observed to find which is significant. If apparently both are significant, the biggest value of adjusted Rsquare between those models will be used to determine whether hypothesis 1 is supported.

The variability of NI and TCI were compared with the basis of standard deviation. Higher standard deviation reflects higher variability.

Predictive ability of NI and TCI on the third hypothesis proposed in this research was tested using third model and fourth model are as follows (Dechow and Schrand, 2004):

$$CFO_{it+1} = \alpha_0 + \beta NI_{it} + \varepsilon_{it} \tag{3}$$

$$CFO_{it+1} = \alpha_0 + \beta TCI_{it} + \varepsilon_{it} \tag{4}$$

Notes:
CFO_{it+1} = one-year-ahead cash flow from operating activities are scaled by average number of shares.

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From those two models, the coefficient (β) of NI or TCI was then observed to find which is significant. If apparently both are significant, the highest value of adjusted Rsquare between those models will be used to determine whether hypothesis 1 is supported.

The predictive ability of NI and TCI was also tested by comparing which of NI or TCI is capable to predict NI in the following year. The test applied model 5 below (Dechow and Schrand, 2004):

$$NI_{it+1} = \alpha_0 + \beta TCI_{it} + \varepsilon_{it} \tag{5}$$

If the coefficient (β) of NI in model 1 is higher than the coefficient (β) of TCI in model 5, hypothesis 4 is supported.

The value relevance of NI and TCI was tested using model 6 to 11. Model 6 to 9 were applied to test the fifth hypothesis proposed in this research. The test of value relevance was carried out using return model (Dechow, 1994 and Easton, 1999) and price model (Dhaliwal, 1999) as follows:

$$R_{it} = \alpha_0 + \beta NI_{it-} p_{t-1} + \varepsilon_{it} \tag{6}$$

$$R_{it} = \alpha_0 + \beta TCI_{it} \ p_{t-1} + \varepsilon_{it} \tag{7}$$

$$P_{it} = \alpha_0 + \beta_1 BV_{it} + \beta_2 NI_{it} + \varepsilon_{it} \tag{8}$$

$$P_{it} = \alpha_0 + \beta_1 BV_{it} + \beta_2 TCI_{it} + \varepsilon_{it} \tag{9}$$

Notes:

R_{it} = annual average of equity return of the company i in year t, calculated from the stock price gap of year t and t-1, scaled with the stock price of year t-1.

P_{it} = price per share of the company i at the end of the fiscal year t

BV_{it} = book value per share of the company i at the end of the fiscal year t

$NI_{it-} P_{t-1}$ = net income to common per share of company i in year t are scaled beginning-of-year stock price

$TCI_{it} P_{Pt-1}$ = total comprehensive income to common per share of company i in year t are scaled beginning-of-year stock price

If the coefficient (β) of NI in model 6 and or 8 is higher than the coefficient (β) of TCI in model 7 and or 9, hypothesis 5 is supported.

The research by Hirst and Hopkins (1998) results in different conclusion when other comprehensive income is not comprehensively presented collaboratively with income statement. Hence, OCI location as the determinant of the difference between NI and TCI shall be a notice to the user. By modifying the model used by Kabir and Laswad (2011), the following model 10 and 11 were applied:

$$R_{it} = \alpha_0 + \beta_1 TCI_{it-} p_{t-1} + \beta_2 TCI_{it-} p_{t-1} Period_t + \varepsilon_{it} \tag{10}$$

$$R_{it} = \alpha_0 + \beta_1 BV_{it} + \beta_2 TCI_{it} + \beta_3 TCI_{it} * Period_t + \varepsilon_{it} \tag{11}$$

$Period_t$ = dummy variable for year t, 1 if the company reported OCI in its income statement, 0 if the company reported OCI in the statement of changes in equity.

From the models above, if the coefficient β_2 and or β_3 of TCI interaction and the dummy variable, i.e. $\beta_2 TCI_{it-} P_{t-1} * Period_t$ and or $\beta_3 TCI_{it} * Period_t$ is positive significant, hypothesis 6 is then supported.

5 FINDINGS

5.1 Descriptive statistic

The data of manufacturing firms listed in Indonesia stock exchange during the observation period was acquired from Fact Book published annually by Indonesia Stock Exchange. The following is the sampling result for the hypothesis testing:

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Table 1.   Sample.

Manufacturing firms in BEI from 2008–2014	122 companies
Observation	854 firm-year observations
Financial statements are not available	45 firm-year observations
NI and TCI are the same (have no OCI items)	425 firm-year observations
Total observation for model 1 to 5 examinations	384 firm-year observations
Closing Prices are not available	7 firm-year observations
Total observation for model 6 to 11 examinations	377 firm-year observations

The descriptive statistics for the 384 firm-year observations and 377 firm-year observations is as follows:

Table 2.   Descriptive statistics.

Variables	N	Mean	SD
NI_t	384	0.000389	0.002911
NI_{t+1}	384	0.000201	0.000546
TCI_t	384	0.000411	0.002966
TCI_{t+1}	384	0.000223	0.000551
CFO_t	384	0.000431	0.002980
CFO_{t+1}	384	0.000244	0.000587
NI_P_{t-1}	377	0.238057	1.344062
TCI_P_{t-1}	377	0.410249	2.417801
TCI_P_{t-2}*Period	377	0.132658	0.918423
TCI_t*Period	377	336.663993	2979.028206
Return	377	0.002869	0.009169
BV	377	1805.083269	3820.573128
Pt	377	4539.917800	22857.704920

From the table above, the total comprehensive income (TCI) of manufacturing firms is more diverse than net income (NI) as represented by the higher standard deviation. It indicates that TCI is more volatile due to OCI. However, both the standard deviation and average of NI and TCI are nearly similar, most likely due to small percentage of OCI compared to total asset, which is at 1.6%. The return between firms is less diverse as presented by low standard deviation.

5.2   Result of hypothesis testing

The testing result of all hypotheses is displayed in Tables 3 and 4 below:

Table 3.   Result of hypothesis testing.

	Model				
	1	2	3	4	5
	Dependent variables				
	NI_{it+1}	TCI_{it+1}	CFO_{it+1}	CFO_{it+1}	NI_{it+1}
Independent variables					
Constant	0.000	0.000	0.000	0.000	0.000
	(6.751***)	(7.466***)	(7.769***)	(7.766***)	(6.737***)
NI_{it}	0.036 (3.835***)		0.030 (2.912***)		
TCI_{it}		0.035		0.027	0.034
		(3.721***)		(2.727***)	(3.725***)
N	384	384	384	384	384
Adjusted R^2	0.035	0.032	0.019	0.017	0.033
F-statistic	14.708***	13.847***	8.478***	7.435***	13.879***

Notes: Statistically significant at *10, **5, and ***1 percent.

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Table 4.   Result of hypothesis testing.

Dependent variables	Model					
	6	7	8	9	10	11
	Dependent variables					
	R_{it}	R_{it}	P_{it}	P_{it}	R_{it}	R_{it}
Independent variables						
Constant	0.003 (5.932***)	0.003 (5.603***)	1694.322 (1.287)	1671.622 (1.273)	0.003 (5.697***)	1781.276 (1.352)
NI_{it}_P_{Pt-1}	0.000087 (0.249)					
TCI_{it}_P_{Pt-1}		0.001 (2.580***)			0.001 (2.867***)	
TCI_{it}_P_{Pt-1} * PERIOD					-0.001 (-1.268)	
BV_{it}			1.757 (4.045***)	1.790 (4.130***)		1.877 (4.244***)
NI_{it}			-0.825 (-1.461)			
TCI_{it}				-0.869 (-1.572)		-4.005 (-1.240)
TCI_{it} * PERIOD						3.096 (0.986)
N	377	377	377	377	377	377
Adjusted R^2	-0.003	0.015	0.048	0.048	0.016	0.048
F-statistic	0.062	6.659***	10.385***	10.560***	4.138**	7.364***

Notes: Statistically significant at *10, **5, and ***1 percent.

Model 1 and 2 were applied in the test of persistence of NI and TCI in hypothesis 1. From the test result in Table 3, both models are significant, either NI or TCI influences one-year-ahead NI and one-year-ahead TCI. However, if compared to adjusted R^2 of both equations, model 1 has higher adjusted R^2, thus hypothesis 1 proposing that NI is more persistent than TCI is supported. This corresponds to the finding of Kabir and Laswad (2011).

The variability of NI and TCI in the second hypothesis was tested by the comparison of standard deviation. From the result in Table 2, standard deviation of TCI is higher than that of NI, indicating the higher variability of TCI than NI. Thus, hypothesis 2 is supported.

Table 3, specifically in model 3 and 4, illustrates the test result of predictive ability of NI and TCI as the third hypothesis. Both models imply the significancy of NI and TCI in predicting one-year-ahead CFO, yet the adjusted R^2 of model 3 (0.019) is higher compared to model 4 (0.017). Therefore, hypothesis 3 is supported, denoting that the predictive ability of NI to predict one-year-ahead CFO is better than TCI. The predictive ability of NI and TCI to predict one-year-ahead NI was also tested using model 1 and 5. In model 1 and 5 at Table 3, both NI and TCI are significant to predict one-year-ahead NI. However, the adjusted R^2 of model 1 is higher than that of model 5. Thus, hypothesis 4 is supported, clarifying that the predictive ability of NI to predict one-year-ahead NI is better than TCI.

The value relevance of NI and TCI was tested using model 6 to 9. As clarified in Table 4, only model 7 that exhibits the capability of TCI in describing stock return significantly at 1%, whereas NI is on the contrary. In the price model, either NI or TCI is incapable of describing stock price. Thus, hypothesis 5 is supported that the value relevance of NI differs from TCI.

The response of the users of income statement towards TCI may also be influenced by OCI location. Model 10 and 11 were used to test such assumption. As the result, Table 4 presents how model 10 and 11 clarify that OCI location is insignificant for the users in responding

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to TCI. Hypothesis 6 is then unsupported, so the TCI reporting location does not affect the relevance of TCI values.

Although the result of this research signifies that NI is more persistent and has a better predictive capability than TCI, the comparison of adjusted R2 of both items only shows slight difference. NI is even less variable than TCI, and the gap of standard deviation between the two is tight. The possible cause concerns with the sample of this research that comprises manufacturing companies. Manufacturing companies have small amount and low frequency of unrealized gain or losses compared to service and financial companies (Dhaliwal et al., 1999) so that the influence of unrealized gain or losses to net income or comprehensive income is relatively low.

6 CONCLUSION, LIMITATION, AND FUTURE RESEARCH

The purpose of this research is to acquire empirical evidence on the comparison between properties of net income and total comprehensive income. The result of this research demonstrates that net income is more persistence, less volatile, and greater in predicting one-year-ahead cash flows from operation, than total comprehensive income. In contrast, total comprehensive income is more capable in describing stock return than net income and the location of OCI is insignificant towards the value relevance of TCI.

The finding of this research verifies the research by Kanagaretnam (2009) affirming that total comprehensive income may describe stock return. Thus, this research does not corroborate the researches by Bidlle and Choi (2006), Dhaliwal et al (1999), and Kabir and Laswad (2011) concluding that net income in comprehensive income reporting is more capable in describing return than total comprehensive income. This research also promotes the research by Kabir and Laswad (2011) about persistence, variability, and predictive ability that suggests net income is more capable in those three properties, yet only has subtle difference if compared with total comprehensive income. This research may demonstrate how total comprehensive income excells over net income, yet still being under net income in connection with the foregoing properties. By this conclusion, this result may not present full endorsement towards the implementation of PSAK No. 1 of 2009.

This research does not support the hypothesis formulating that the location of OCI influences the value relevance of TCI. The inability of this research in supporting such hypothesis may be due to the low frequency and amount of unrealized gains and losses of the manufacturing companies compared to those of finance companies. In accordance with the aforementioned, further research is expected to conduct retest on companies with high other comprehensive income, e.g. companies engaging in service and financial industries.

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comparing properties of net income

by Ari Kuncara Widagdo

Comparing properties of net income and total comprehensive income: A study on manufacturing industry in Indonesia

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ABSTRACT: The purpose of this research is to acquire empirical evidence of the benefit of PSAK No. 1 (2009) implementation by testing whether the properties of total comprehensive income are better than those of net income. Four properties of net income and of total comprehensive income were compared. This research also investigated whether the value relevance of total comprehensive income depends on location where the users can obtain this information.

Stock return was measured with average daily stock returns over the fiscal year subtracted with market return. A dummy variable was applied to determine companies that report Other Comprehensive Income (OCI) in their equity statement or in their comprehensive income statement. For companies with OCI, the dummy variable was used to determine the period before and after the implementation of PSAK No. 1 (2009). It represents a place where the users can obtain information about total comprehensive income. This study used a sample of 122 manufacturing firms listed in the Indonesian Stock Exchange from 2008 to 2014. The analytical tool used to test all hypotheses was ordinary least square.

The result of this research demonstrates that net income is more persistence, less variable, and more have predictive ability than total comprehensive income, yet total comprehensive income has more value relevance than net income. In addition, this research reveals that location of OCI is insignificant for the value relevance of total comprehensive income.

Keywords: Indonesia, persistence, variability, predictive ability, value relevance, net income, total comprehensive income, and other comprehensive income

1 INTRODUCTION

PSAK No. 1 (2009) that adopts IAS No.1 of 2009, effective for fiscal year beginning on 1 January 2011 or after, regulates the presentation of comprehensive income statement. The presentation of comprehensive income statement of a period that covers the net income of such period added or subtracted with the changes in other comprehensive income (OCI) items provides information that aid investors and creditors to comprehend more about transformation in equity interest and a company's ability in generating future cash flow (Casabona, 2014). The distinction of income statement presentation after PSAK is only in the disposition of other comprehensive income presentation, which was previously presented in the statement of changes in equity.

The benefits of comprehensive income can be viewed from two perspectives: investor usefulness and contracting usefulness (Black, 2015). Those benefits have been studied as a response to the establishment of SFAS 130 of 1997, with various research results. Some

support the appeal for comprehensive income statement presentation, yet some others do not. Those who support the idea claim that clean surplus describing only net income and dividend is internally consistent, less supportive to manipulation, and more suitable with valuation theory. On the other hand, those who do not support such idea state that earnings should be summarized from the influence of transitory to illustrate current operating performance and the manager will exclude items that exceed their capability to control those items (Biddle and Choi, 2006).

Earnings quality is observable from 4 perspectives: persistence, volatility, ability to predict one-year-ahead cash flows from operating activities and net income, and association with contemporaneous stock returns (Dechow and Schrand, 2004). Comprehensive income statement determines which of net income or total comprehensive income (TCI) is more qualified, and whether the location of OCI reporting influences the total comprehensive income in explaining stock return. Kabir and Laswad (2011) have confirmed that net income is more persistent and more capable in explaining stock return than TCI. The variability and predictive ability of both are indifferent. In addition, the location of OCI does not influence the value relevance of TCI. Moreover, they distinguish the location of OCI presentation on the basis of whether the comprehensive income is a single continuous statement of comprehensive income or two separate but consecutive statement. However, nearly all companies in Indonesia report OCI in a single continuous statement of comprehensive income. Therefore, this study aims to retest the research conducted by Kabir and Laswad (2011), yet depending on whether OCI is reported in the statement of changes in equity or in the income statement (comprehensive income) to determine the location of OCI reporting.

Whether the location of OCI presentation about income statement is beneficial becomes a concern for some researchers. Hirst and Hopkins (1998) demonstrate with experiment method that an explicit disclosure of income statement on comprehensive income and its component can effectively improve transparency of earnings management activity and reduce the analyst's valuation judgment. Maines & McDaniel (2000) find out that the participants significantly weigh on their volatility valuation when unrealized gains and losses (URGL) appeared in SFAS 130 comprehensive income, but not in alternative SFAS 130 (URGL reported in changes in equity) and statement of changes in equity SFAS 115. On the contrary, Chambers (2007) confirms otherwise. OCI is valued by investors when it stands on the statement of changes in equity because investors are familiar with the predominant OCI presentation location. While Darsono (2012), who proved that the role of OCI information before the regulation on comprehensive income presentation is effective, verifies that OCI influences company value. Since he acquires OCI information from the statement of changes in equity, his finding then confirms that there is no issue about OCI presentation location.

The experiment by Hirst and Hopkins (1998) divides participants into two groups, namely a group with comprehensive income report (CI) and a group without comprehensive income report (non CI), which that comprehensive income information is presented in the statement of changes in equity. The result points out some differences. Based on that, this research would like to retest the research by Kabir and Laswad (2011) in connection with the location of OCI, because according to the research by Hirst and Hopkins (1998), the result would be different when other comprehensive income is not comprehensively presented together with the income statement. Even in the discussion about the research by Hirst and Hopkins (1998), Lipe (1998) emphasizes that even if another group of participant is added, which is the participant informed with the source of another comprehensive income (CI) out of the income statement, the results is much the same, different from the expected result which processing and judgment would be different from the non CI group. It reveals that CI format apparently has advantages.

Value relevance is the correlation of financial statement numbers with the price or stock return. Many researches on earnings value relevance and its items have been conducted. Lipe (1986) finds that stock return variation of industrial and commercial companies are explained better by earnings component than aggregate earnings. Brown (2001), who compares the quality of earnings by three earning components, namely net income, earning per share from operation, and earning per share before extraordinary item, finds that net

income has higher earnings quality compared to the other. Jaggi and Zhao (2002), who specifically research the impact of transformation from SFAS 12 into SFAS 115 of 1993 about available-for-sale financial assets reclassification, find that the information of earnings components is more relevant for investment decisions after the implementation of SFAS 115.

The result of the research shows that net income in compliance with SFAS 130 dominates traditional net income (Biddle and Choi, 2006) and total comprehensive income (Bidlle and Choi, 2006; Kabir and Laswad, 2011) in explaining stock return. Chambers, et al. (2007) who specifically demonstrate the benefit of other comprehensive income presentation prove that two components of other comprehensive income, which are foreign currency translation adjustment and unrealized gains and losses from available securities for sale, have higher value relevance than the other components. It appears so for Lin, et al. (2007) as well, who uses samples from various country, that confirms that total other comprehensive income has value relevance beyond net income in many countries, but comprehensive income has less value relevance than the other measurement of income, which are operating income and net income. On the other hand, the researches that do not promote the use of comprehensive income statement are that by Dhaliwal et al. (1999) and Doukakis (2010). Dhaliwal et al. (1999) conclude that comprehensive income is not closely associated with stock return nor predicts cash flow or earnings better than net income. Doukakis (2010), who employed the adoption of IFRS phenomenon, validates that the adoption of IFRS that requires comprehensive income statement presentation does not improve persistence of earnings and its component systematically for future profitability. On the contrary, operating and non-operating income persistence are lower, so is the explanatory power after the adoption of IFRS.

With a variety of confirmation about the use of comprehensive income statement, this research aims to test the use of comprehensive income statement in Indonesia for the regulation on comprehensive income statement reporting has only been effective since 2011. This research highlights the role of comprehensive income statement presentation with the perspective of investors usefulness in describing investors' response. Since there is an OCI component that becomes the distinctive feature of comprehensive income statement presentation compared to the previous version of presentation, this research therefore highlights the role of OCI in differentiating the presentation format.

From the view of efficient market hypothesis, the market reaction will be indifferent since investors are not affected by where the information is presented. They can still utilize the information to make decision. However, based on the argument that a market cannot be as efficient as expected, and low stock price proportion that can be explained by historical net income (Scott, 2015), measurement approach and clean surplus theory justify the significance of a research on investors' reaction to the transformation of this income statement presentation.

It is substantial to compare the earnings quality between net income and total comprehensive income in order to determine which of the two is better to use for company performance assessment (Black, 1993). Furthermore, evidences are currently required to evaluate the implementation of PSAK No. 1 (2009). Based on information that 11 of the 20 companies with the largest market capitalization in the Indonesia Stock Exchange have business in manufacturing industry sector (www.kemenperin.go.id), this research focuses on the manufacturing industry, by testing whether the net income and total comprehensive income have differences in earnings quality and value relevance.

This research used 384 manufacturing firm-year observations to test the persistence, variability, and predictive ability of NI and TCI, and 377 manufacturing firm-year observations were used to test the value relevance of both. Observations were conducted from 2008 to 2014, 3 years prior to the presentation of comprehensive income, and 4 years after. This research validates that NI is more persistent, less variable, and more capable in predicting operating cash flow than TCI, with slight difference. On the other hand, unlike NI, TCI may explain return, yet the location of OCI does not influence the value relevance of the TCI.

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2 LITERATURE REVIEW

2.1 *Comprehensive income*

Accounting information serves a purpose of providing information for investors about the company's performance to make business decision and to evaluate managers' performance. Designing and implementing well-combined concept and standard, the role of accounting information for the investors, and evaluating the managers' performance are the fundamental issues of accounting theory.

Scott (2015) explains that in ideal condition, there isn't any fundamental issues of accounting theory. The application of current value based accounting in financial reporting is second best condition. Although the use of current accounting in financial reporting is more realistic, the fundamental issues of accounting theory such as mentioned above will still persist. Current value reflects more about the value in the mean time so that it will be more preferable by the investors. Yet, it can be less preferable because the investors are accustomed to historical cost. Moreover, current accounting includes unrealized gain or losses of assets and debts changes. It can increase income volatility and does not reflect the actual performance of managers, and it should not be used to assess operating performance of managers because unrealized gain or losses is not the result of operating performance.

Current value of assets and debts is more potential than historical cost in drawing investors' attention because current value provides the finest available indication on company performance and future investment return. However, managers might think that unrealized gains and losses from the adjustment of assets' and debts' registered value in the current value does not reflect their actual performance. Accounting standards board immediately mediates conflict of interest between managers and investors by trying to make standards that can accommodate the interest of both sides.

Comprehensive income statement covers all changes in equity of the shareholders except transactions with the shareholders as in stock purchase or repurchase and dividend distribution (Casabona, 2014). Ohlson (1995) states that all changes in asset/debt that are not related to dividend have to go through income statement. So, comprehensive income is the income that covers all changes of asset/debt that are not related to the transactions with the owner (changes from dirty surplus to clean surplus).

PSAK No. 1 of 2009 demands all companies to present earnings in comprehensive income statement that elaborates such component into gross profit, operating income, current earning of the year which is net income before other comprehensive income, other comprehensive income, and comprehensive income. The fundamental change of PSAK No. 1 of 2009, effective from 2011, compared to the previous PSAK is the separation of unrealized gains and losses into the category of other comprehensive income. Other comprehensive income contains: unrealized gains and losses of available-for-sale financial assets (PSAK 55), revaluation surplus of tangible and intangible assets (PSAK 16 and 19), gains and losses of defined benefit plan actuary, gains and losses of foreign exchange rate changes from overseas business operation (PSAK 10), and gains and losses of hedging instrument (PSAK 55).

The first step of the comprehensive income concept implementation was executed through SFAS No. 130, issued by FASB in 1997. SFAS No. 130 is a request from AIMR (Association for Investment and Research) that recommends several changes in financial reporting model. That standard demands companies to report comprehensive income along with its components in a statement with similar eminence to basic financial statement (Hirst and Hopkins, 1998). Initially, comprehensive income statement for a reporting period covers net income, as reported in income statement, added or subtracted with items of other comprehensive income unreported in income statement. In June 2011, FASB issued Accounting Standar Update (ASU) No. 2011–05 that regulates the manner of presentation of entities to report comprehensive income in financial statement. Previous FASB directive through Accounting Standar Codification (ASC) 220–45–8 allowed three options in reporting comprehensive income as follows (Casabona, 2014): 1) the total of comprehensive income of a period, as well as other comprehensive income, can be reported under net income total in a single

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combined statement of income and comprehensive income, 2) in separated comprehensive income statement beginning with net income, and 3) in equity statement of the shareholders. Later on, ASU 2011–05 removed the third option, so these two options remain: a single continuous statement of comprehensive income and two separate but consecutive statement. By a single continuous statement of comprehensive income, entities have to include the component of net income, total of net income, component of other comprehensive income, total of other comprehensive income, and total of comprehensive income. Whereas by two-separated-but-consecutive-statement, entities have to report the components of net income and total of net income in net income statement (which is income statement), that has to be followed up with statement of other comprehensive income covering components of other comprehensive income and total of other comprehensive income, and total of comprehensive income. PSAK No. 1 of 2009 also provides 2 options of comprehensive income statement as in ASU 2011–05, which are single and separated.

2.2 Value relevance of earnings

Earnings figure is the main concern in a financial statement. By looking at earnings figure, the financial statement information receivers can view a company's overall performance. Earnings are the function of a company's financial performance, and such function demonstrates the accounting system that converts unobservable financial performance into observable earnings figure (Dechow et al. 2010). Therefore, earnings figures cannot completely describe a company's financial performance. Why can't accounting measuring system completely measure the actual performance of a company? Dechow et al. (2010) present three reasons. First is various models of decision. An accounting system that delivers single earnings figure statement cannot provide relevant financial performance representation for all kinds of decisions. The decision maker board creates trade-off to anticipate the users' needs, and eventually there isn't any single decision makers that acquires the image of performance of the company that is perfectly relevant for decision making. Second is the variation in financial performance measurement. There is no single standard that will measure financial performance perfectly for all kinds of company. As an example, the means of COGS (cost of good sold) measurement depends on when a company recognize its revenue. Different companies go with different basis of recognition. Third is implementation. An accounting system that measures unobservable financial performance construct inherently involves estimation and judgment. It can cause either unintentional or intentional mistake (example: earnings management).

How faithful earnings explain actual financial performance is in fact approached with the earnings quality. Earnings quality is a concept that has no general definition in the literature. Schipper and Vincent (2003) define earnings quality from the decision usefulness perspective, that is how faithful an income explains Hicksian income, including assets' net changes other than transactions with the owner. Ayres (1994) states that earnings quality is related to permanent earnings, which is high quality of earnings that portrays sustainable earnings for a long period of time. Bellovary et al. (2005) defines earnings quality as the ability of the reported income to explain a company's actual earning, just like the ability of reported income to predict future earnings. Earnings quality also explains stability, persistence, and low variability of the reported income.

A high quality of earnings figure may deliver the description of current operating performance, a good indicator of future operating performance, and accurate representation of a company's intrinsic value. However, not all earnings figures are created equal due to the dependency of earnings on the compositions of the earnings itself, the stage of the firm's life cycle, the time period, and the industry (Dechow and Shcrand, 2004).

Measuring earnings quality is significant because earnings are normally used to arrange compensation or debt agreement. A contract decision based on low quality earning will result in an unexpected welfare transfer. For example, an overstated income that is used as an indicator of manager performance will create an overstated compensation as well. From the

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perspective of investment, low earnings quality is unwanted because it is a signal of poor resource allocation, which is inefficient because it distorts potential projects to less profitable projects.

Cornell and Landsman (2003) express that the disagreement on earnings quality is based on more fundamental issue. The key issue that becomes a concern for the regulators and standards board is an efficient capital allocation in a proper capital market function. The precondition for efficient allocation is that market value explains economic value as big as possible. They make two arguments as follows: 1) not even a kind of earnings measurement, including GAAP, satisfyingly represents financial statement information for the purpose of prediction, 2) there is no meaningful criteria to determine whether an earnings measures better than the other components, even for certain companies, than by experience in predicting, and then determining that historical time series is more accurate for predicting.

2.3 *Incomplete revelation hypothesis*

In the efficient market hypothesis, the form of presentation, either simple or detailed, will not influence the judgment of information users because in an efficient market, the users of information can process all kinds of information quickly and properly. However, the information receiver might react differently toward different kind of information presentation form. The theory that explains such possibility is Incomplete Revelation Hypothesis (Bloomfield, 2002) or IRH. IRH predicts that investors use substantial resource to identify mispriced stock on the basis of public data, where manager tries to increase stock price by hiding bad news in the footnotes, and where the regulators want to prevent such effort, because the information that is difficult to be extracted from the financial statement will not be reflected in the stock price.

IRH distinguishes data from statistics. Data is written text or numbers or the ones saved in the computer file. Whereas statistics is useful facts that are extracted from that data, for example is profit figures or financial ratio. So if the data is extracted into meaningful information, then it becomes statistics. Market players have various tolerance towards the risk and funds related to that risk. Statistics can increase trading desire if the sellers collect it more and if those who collect it have big risk tolerance. Statistics with expensive extraction cost from available public information on the contrary will decrease trading desire, and such statistics will not completely reflected in the stock price. So, EMH predicts that stock market price completely describes all available public information, but IRH is otherwise. IRH predicts that stock market price does not completely describe all available public information.

IRH is also supported by psychological researches that prove that an information will not be used if it is unavailable and not processed immediately. Therefore, Hirst and Hopkins (1998) suggest that the judgment of analyst valuation will be influenced with the clarity of relevant information value disclosure. By applying experiment method, they find that an explicit disclosure of income statement in comprehensive income and its items can improve the transparency of management activity and company profit, and diminish the judgment of analyst valuation.

3 HYPOTHSES

As Kabir and Laswad (2011) once performed, this research also observed 6 hypotheses.

3.1 *Persistence and variability of NI and TCI*

PSAK No. 1 of 2009 demands all companies to present earnings in comprehensive income statement that elaborates it into gross profit, operating income, current earning of the year which is net income before OCI, OCI, and TCI. OCI comprises unrealized gains and losses from several items, arising from the fair value change of asset or liability.

The unrealized gain or losses from the value changes of assets and debts can increase income volatility (Scott, 2012) because it is transitory and does not describe core earning (Chambers, et al., 2007), which is income earned from the core activity of the company. Income volatility will complicate the investors to make return estimation in assessing investment. Unrealized gain or losses also does not reflect the actual performance of managers, and it should not be used to assess operating performance of managers because unrealized gain or loss is not the result of operating performance. Unrealized gain or loss is influenced by market factors that cannot be controlled by managers and usually is a result of unpredictable random process (Chambers, et al., 2007). Thus, NI may be more persistent compared with TCI, and TCI is more variable than NI.

H1: NI is more persistent than TCI.
H2: The cross-sectional variation of TCI is more than that of NI.

3.2   *Predictive ability of NI and TCI*

Cash flow of the operating activities is the cash flow utilized and deriving from the primary activities of the company. Unrealized gains and losses from non-primary activities are reported as OCI which is a component of TCI. Therefore, a question is raised concerning which of NI or TCI that is more capable in predicting future cash flows.

Two arguments were then developed. The followers of all-inclusive (clean surplus) believe that TCI contains all changes of economic value resulting from every company activity excluding transactions with the owner. Therefore, investor and creditor will exhaustively comprehend the future prospect of the firm and will be capable to predict future earnings and cash flows in a better manner (Kanagaretnam, 2009). From another point of view, those who promote current operating income (dirty surplus) consider that net income shall define the strength of permanent earnings of a company gained from the primary and repeated company activity that is measured objectively using historical cost based on realization principle. The change of company value resulting from transitory activity may impair its predictive capability.

Kanagaretnam (2009) finds that total comprehensive income correlates more to price and stock return and predicts future cash flows better than net income. Contrarily, Barth et al. (2001) and Dechow and Schrand (2004) confirm that NI predicts future cash flows and NI better than accruals earned from the transitory change of value within TCI.

H3: Predictive ability of NI to predict one-year-ahead CFO is better than TCI.
H4: Predictive ability of NI to predict one-year-ahead NI is better than TCI.

3.3   *Value relevance of NI and TCI*

Value relevance is the ability of financial statement information to capture or summarize information that influences the company value (Collins et al., 1997; Francis and Schipper, 1999) or stock price (Hellstorm, 2005). High earnings quality provides information about the company's financial performance that is relevant to make specific decision. Income is related to capital market performance. An earnings is high in quality if the correlation between income and stock price or market return is strong. By so, the measurement of earnings value relevance is performed by testing the correlation between earnings and stock price.

Lipe (1986) finds that stock return variation of industrial and commercial companies are better explained by earnings component than aggregate earnings. He find that every component provides information that completes aggregate earnings information, and if the information of earnings component is merged into aggregate earnings figure, then that information will disappear. Different from Lipe (1986), Jaggi and Zhao (2002) specifically conduct a research on the impact of the change of SFAS 12 into SFAS 115 of 1993 that reclassifies the presentation of investment securities on banking corporation. Securities reclassification is expected to decrease management discretion in classifying securities and reduce the gap

of unrealized gains and losses between companies, and further will increase the content of unrealized loss and profit information. The result of their research verifies that the information of earnings component is more relevant for investment decision after the implementation of SFAS 115.

The information content of income and its components can be measured from its correlation with stock return. Investors will react to an information if that information is relevant for them to make decision and it will be reflected in the stock price or stock return. Prior to the implementation of PSAK No. 1 of 2009, companies present income statement consisting of three components; gross profit, operating income, and net income. After the implementation, companies are demanded to present profit in comprehensive income statement that elaborates it into gross profit, operating income, current earning of the year which is net income before other comprehensive income, other comprehensive income, and comprehensive income. With comprehensive income, that has more income components compared to the previous income statement, a question arises about which income is preferred by investors in making decision. In practice, in fundamental analysis, net income still becomes the top priority in making decision on investment. Further, transitory components, or components that are not the core operating activity of the company, become the following consideration. Bidlle and Choi (2006) confirm that net income that conforms with SFAS 130 dominates traditional net income. So do Kabir and Laswad (2011) that prove that net income can explain stock return better than comprehensive income.

From the point of view of investor, income is the amount of profit for the purpose of investment valuation. Investors assess investment based on the opportunity cost, which is market rate of return (Suwardjono, 2005). Thus, from the investors' point of view, income is the internal rate of return of future cash flow that can be earned if those investors invest their assets somewhere else (opportunity cost), meaning if investors invest their assets somewhere else, then that income becomes opportunity cost for them. Income from the point of view of investor is the economic income (real income), which is income in the form of the increase of economic prosperity.

Net income may be more relevant to investors because it is persistent, less varied, and more able to predict return, then net income may be more relevant. However, total comprehensive income may be more relevant than net income because based on IRH information will be used if it is available and processed immediately.

H5: The value relevance of NI differs from TCI.

The fundamental change of PSAK No. 1 of 2009 compared to previous PSAK lies in the presentation of unrealized gains and losses components into other comprehensive income category previously presented in the changes of equity. The location of OCI is evidently capable to improve the transparency of earnings management activities and reduce the analyst's valuation judgement (Hirst and Hopkins, 1998) as well as influence the use of volatility to assess company performance (Maines & McDaniel, 2000). Although all information in an efficient capital market can be processed by the information users, the users of financial statement prefer to utilize the information when such information is clear and presented with simple method (Johson, et al. 1988). It is the foundation to predict that the location of OCI presentation in comprehensive income statement is more beneficial than the presentation in changes of equity statement.

H6: The value relevance of TCI differs depending on its reporting location.

4 METHODOLOGY

4.1 *Data and sample*

The accounting data for this research was taken from complete financial statement retrieved from www.idx.co.id and the market data was taken from daily stock price acquired from Indonesia Stock Exchange corner. The population of this research is the companies listed in

Indonesia Stock Exchange (Bursa Efek Indonesia/BEI), and the sample of this research is the manufacturing companies listed in BEI from 2008 to 2014. The sample collection technique applied was purposive sampling method with the criteria that financial statement and market price data were acquired from 2007 to 2015.

4.2 Variables and operational definition of variables

The variables in this research are:

4.2.1 Dependent variable

The dependent variables for this research are one-year-ahead net income (NI_{t+1}), one-year-ahead total comprehensive income (TCI_{t+1}), one-year-ahead cash flow from operation (CFO_{t+1}), stock return (R_t), and stock price (P_t). The value relevance of earnings in this research was measured with stock return, which is the equity return of company t in year t, that was calculated from the gap of stock price of year t and t−1 added with dividend per share of year t, scaled with stock price of year t−1. Since the companies that divided the dividend is only few from the entire sample, then the numbers of dividend is ignored.

4.2.2 Independent variable

The independent variable for this research is net income of the current year, that is net income before other comprehensive income (NI), total comprehensive income (TCI), book value (BV), and the presentation of OCI location (Period), which is the period before the implementation of statement of comprehensive income where OCI is located in the statement of changes in equity and the period after the implementation of comprehensive income reporting where OCI is incorporated within the income statement.

4.3 Models

The first and second model to test the persistence of NI and TCI in the first hypothesis proposed in this research are as follows (Dechow and Schrand, 2004):

$$NI_{it+1} = \alpha_0 + \beta NI_{it} + \varepsilon_{it} \qquad (1)$$

$$TCI_{it+1} = \alpha_0 + \beta TCI_{it} + \varepsilon_{it} \qquad (2)$$

Notes:

NI_{it} = net income of company i in year t are scaled by the weighted average number of shares.

TCI_{it} = total comprehensive income of company i in year t are scaled by the weighted average number of shares.

From those two models, the coefficient (β) of NI or TCI variable is observed to find which is significant. If apparently both are significant, the biggest value of adjusted Rsquare between those models will be used to determine whether hypothesis 1 is supported.

The variability of NI and TCI were compared with the basis of standard deviation. Higher standard deviation reflects higher variability.

Predictive ability of NI and TCI on the third hypothesis proposed in this research was tested using third model and fourth model are as follows (Dechow and Schrand, 2004):

$$CFO_{it+1} = \alpha_0 + \beta NI_{it} + \varepsilon_{it} \qquad (3)$$

$$CFO_{it+1} = \alpha_0 + \beta TCI_{it} + \varepsilon_{it} \qquad (4)$$

Notes:

CFO_{it+1} = one-year-ahead cash flow from operating activities are scaled by average number of shares.

From those two models, the coefficient (β) of NI or TCI was then observed to find which is significant. If apparently both are significant, the highest value of adjusted Rsquare between those models will be used to determine whether hypothesis 1 is supported.

The predictive ability of NI and TCI was also tested by comparing which of NI or TCI is capable to predict NI in the following year. The test applied model 5 below (Dechow and Schrand, 2004):

$$NI_{it+1} = \alpha_0 + \beta TCI_{it} + \varepsilon_{it} \tag{5}$$

If the coefficient (β) of NI in model 1 is higher than the coefficient (β) of TCI in model 5, hypothesis 4 is supported.

The value relevance of NI and TCI was tested using model 6 to 11. Model 6 to 9 were applied to test the fifth hypothesis proposed in this research. The test of value relevance was carried out using return model (Dechow, 1994 and Easton, 1999) and price model (Dhaliwal, 1999) as follows:

$$R_{it} = \alpha_0 + \beta NI_{it-} p_{t-1} + \varepsilon_{it} \tag{6}$$

$$R_{it} = \alpha_0 + \beta TCI_{it-} p_{t-1} + \varepsilon_{it} \tag{7}$$

$$P_{it} = \alpha_0 + \beta_1 BV_{it} + \beta_2 NI_{it} + \varepsilon_{it} \tag{8}$$

$$P_{it} = \alpha_0 + \beta_1 BV_{it} + \beta_2 TCI_{it} + \varepsilon_{it} \tag{9}$$

Notes:

R_{it} = annual average of equity return of the company i in year t, calculated from the stock price gap of year t and t-1, scaled with the stock price of year t-1.

P_{it} = price per share of the company i at the end of the fiscal year t

BV_{it} = book value per share of the company i at the end of the fiscal year t

$NI_{it-} P_{t-1}$ = net income to common per share of company i in year t are scaled beginning-of-year stock price

$TCI_{it} P_{Pt-1}$ = total comprehensive income to common per share of company i in year t are scaled beginning-of-year stock price

If the coefficient (β) of NI in model 6 and or 8 is higher than the coefficient (β) of TCI in model 7 and or 9, hypothesis 5 is supported.

The research by Hirst and Hopkins (1998) results in different conclusion when other comprehensive income is not comprehensively presented collaboratively with income statement. Hence, OCI location as the determinant of the difference between NI and TCI shall be a notice to the user. By modifying the model used by Kabir and Laswad (2011), the following model 10 and 11 were applied:

$$R_{it} = \alpha_0 + \beta_1 TCI_{it-} p_{t-1} + \beta_2 TCI_{it-} p_{t-1} Period_t + \varepsilon_{it} \tag{10}$$

$$R_{it} = \alpha_0 + \beta_1 BV_{it} + \beta_2 TCI_{it} + \beta_3 TCI_{it} * Period_t + \varepsilon_{it} \tag{11}$$

$Period_t$ = dummy variable for year t, 1 if the company reported OCI in its income statement, 0 if the company reported OCI in the statement of changes in equity.

From the models above, if the coefficient β_2 and or β_3 of TCI interaction and the dummy variable, i.e. $\beta_2 TCI_{it-} P_{t-1} * Period_t$ and or $\beta_3 TCI_{it} * Period_t$ is positive significant, hypothesis 6 is then supported.

5 FINDINGS

5.1 *Descriptive statistic*

The data of manufacturing firms listed in Indonesia stock exchange during the observation period was acquired from Fact Book published annually by Indonesia Stock Exchange. The following is the sampling result for the hypothesis testing:

Table 1. Sample.

Manufacturing firms in BEI from 2008–2014	122 companies
Observation	854 firm-year observations
Financial statements are not available	45 firm-year observations
NI and TCI are the same (have no OCI items)	425 firm-year observations
Total observation for model 1 to 5 examinations	384 firm-year observations
Closing Prices are not available	7 firm-year observations
Total observation for model 6 to 11 examinations	377 firm-year observations

The descriptive statistics for the 384 firm-year observations and 377 firm-year observations is as follows:

Table 2. Descriptive statistics.

Variables	N	Mean	SD
NI_t	384	0,000389	0,002911
NI_{t+1}	384	0,000201	0,000546
TCI_t	384	0,000411	0,002966
TCI_{t+1}	384	0,000223	0,000551
CFO_t	384	0,000431	0,002980
CFO_{t+1}	384	0,000244	0,000587
NI_P_{t-1}	377	0,238057	1,344062
$TCI_t\_P_{t-1}$	377	0,410249	2,417801
$TCI_t\_P_{t-1}$*Period	377	0,132658	0,918423
TCI_t*Period	377	336,663993	2979,028206
Return	377	0,002869	0,009169
BV	377	1805,083269	3820,573128
Pt	377	4539,917800	22857,704920

From the table above, the total comprehensive income (TCI) of manufacturing firms is more diverse than net income (NI) as represented by the higher standard deviation. It indicates that TCI is more volatile due to OCI. However, both the standard deviation and average of NI and TCI are nearly similar, most likely due to small percentage of OCI compared to total asset, which is at 1.6%. The return between firms is less diverse as presented by low standard deviation.

5.2 Result of hypothesis testing

The testing result of all hypotheses is displayed in Tables 3 and 4 below:

Table 3. Result of hypothesis testing.

	Model				
	1	2	3	4	5
	Dependent variables				
	NI_{it+1}	TCI_{it+1}	CFO_{it+1}	CFO_{it+1}	NI_{it+1}
Independent variables					
Constant	0,000	0,000	0,000	0,000	0,000
	(6,751***)	(7,466***)	(7,769***)	(7,766***)	(6,737***)
NI_{it}	0,036 (3,835***)		0,030 (2,912***)		
TCI_{it}		0,035		0,027	0,034
		(3,721***)		(2,727***)	(3,725***)
N	384	384	384	384	384
Adjusted R²	0,035	0,032	0,019	0,017	0,033
F-statistic	14,708***	13,847***	8,478***	7,435***	13,879***

Notes: Statistically significant at *10, **5, and ***1 percent.

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Table 4. Result of hypothesis testing.

Dependent variables	Model					
	6	7	8	9	10	11
	Dependent variables					
	R_{it}	R_{it}	P_{it}	P_{it}	R_{it}	R_{it}
Independent variables						
Constant	0,003	0,003	1694,322	1671,622	0,003	1781,276
	(5,932***)	(5,603***)	(1,287)	(1,273)	(5,697***)	(1,352)
$NI_{it\_}P_{Pt-1}$	0,000087					
	(0,249)					
$TCI_{it\_}P_{Pt-1}$		0,001			0,001	
		(2,580***)			(2,867***)	
$TCI_{it\_}P_{Pt-1}$ * PERIOD					−0,001	
					(−1.268)	
BV_{it}			1,757	1, 790		1,877
			(4,045***)	(4,130***)		(4,244***)
NI_{it}			−0,825			
			(−1,461)			
TCI_{it}				−0,869		−4,005
				(−1,572)		(−1,240)
TCI_{it} * PERIOD						3,096 (0,986)
N	377	377	377	377	377	377
Adjusted R²	−0,003	0,015	0,048	0,048	0,016	0,048
F-statistic	0,062	6,659***	10,385***	10,560***	4,138**	7,364***

Notes: Statistically significant at *10, **5, and ***1 percent.

Model 1 and 2 were applied in the test of persistence of NI and TCI in hypothesis 1. From the test result in Table 3, both models are significant, either NI or TCI influences one-year-ahead NI and one-year-ahead TCI. However, if compared to adjusted R^2 of both equations, model 1 has higher adjusted R^2, thus hypothesis 1 proposing that NI is more persistent than TCI is supported. This corresponds to the finding of Kabir and Laswad (2011).

The variability of NI and TCI in the second hypothesis was tested by the comparison of standard deviation. From the result in Table 2, standard deviation of TCI is higher than that of NI, indicating the higher variability of TCI than NI. Thus, hypothesis 2 is supported.

Table 3, specifically in model 3 and 4, illustrates the test result of predictive ability of NI and TCI as the third hypothesis. Both models imply the significancy of NI and TCI in predicting one-year-ahead CFO, yet the adjusted R^2 of model 3 (0.019) is higher compared to model 4 (0.017). Therefore, hypothesis 3 is supported, denoting that the predictive ability of NI to predict one-year-ahead CFO is better than TCI. The predictive ability of NI and TCI to predict one-year-ahead NI was also tested using model 1 and 5. In model 1 and 5 at Table 3, both NI and TCI are significant to predict one-year-ahead NI. However, the adjusted R^2 of model 1 is higher than that of model 5. Thus, hypothesis 4 is supported, clarifying that the predictive ability of NI to predict one-year-ahead NI is better than TCI.

The value relevance of NI and TCI was tested using model 6 to 9. As clarified in Table 4, only model 7 that exhibits the capability of TCI in describing stock return significantly at 1%, whereas NI is on the contrary. In the price model, either NI or TCI is incapable of describing stock price. Thus, hypothesis 5 is supported that the value relevance of NI differs from TCI.

The response of the users of income statement towards TCI may also be influenced by OCI location. Model 10 and 11 were used to test such assumption. As the result, Table 4 presents how model 10 and 11 clarify that OCI location is insignificant for the users in responding

to TCI. Hypothesis 6 is then unsupported, so the TCI reporting location does not affect the relevance of TCI values.

Although the result of this research signifies that NI is more persistent and has a better predictive capability than TCI, the comparison of adjusted R2 of both items only shows slight difference. NI is even less variable than TCI, and the gap of standard deviation between the two is tight. The possible cause concerns with the sample of this research that comprises manufacturing companies. Manufacturing companies have small amount and low frequency of unrealized gain or losses compared to service and financial companies (Dhaliwal et al., 1999) so that the influence of unrealized gain or losses to net income or comprehensive income is relatively low.

6   CONCLUSION, LIMITATION, AND FUTURE RESEARCH

The purpose of this research is to acquire empirical evidence on the comparison between properties of net income and total comprehensive income. The result of this research demonstrates that net income is more persistence, less volatile, and greater in predicting one-year-ahead cash flows from operation, than total comprehensive income. In contrast, total comprehensive income is more capable in describing stock return than net income and the location of OCI is insignificant towards the value relevance of TCI.

The finding of this research verifies the research by Kanagaretnam (2009) affirming that total comprehensive income may describe stock return. Thus, this research does not corroborate the researches by Bidlle and Choi (2006), Dhaliwal et al (1999), and Kabir and Laswad (2011) concluding that net income in comprehensive income reporting is more capable in describing return than total comprehensive income. This research also promotes the research by Kabir and Laswad (2011) about persistence, variability, and predictive ability that suggests net income is more capable in those three properties, yet only has subtle difference if compared with total comprehensive income. This research may demonstrate how total comprehensive income excells over net income, yet still being under net income in connection with the foregoing properties. By this conclusion, this result may not present full endorsement towards the implementation of PSAK No. 1 of 2009.

This research does not support the hypothesis formulating that the location of OCI influences the value relevance of TCI. The inability of this research in supporting such hypothesis may be due to the low frequency and amount of unrealized gains and losses of the manufacturing companies compared to those of finance companies. In accordance with the aforementioned, further research is expected to conduct retest on companies with high other comprehensive income, e.g. companies engaging in service and financial industries.

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Judul Karya Ilmiah (paper) : Comparing properties of net income and total comprehensive income: A study on manufacturing industry in Indonesia

Jumlah Penulis : 4 Orang (Retno Yulianti, **Ari Kuncara Widagdo**, Doddy Setiawan, Bambang Sutopo)

Status Pengusul : ~~Penulis pertama~~ / penulis ke 2 / ~~penulis korespondasi~~**

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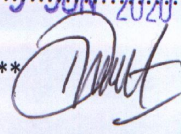
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