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VALUE RELEVANCE OF OTHER COMPREHENSIVE INCOME UNDER INTERNATIONAL FINANCIAL REPORTING STANDARDS WITH AN EMPIRICAL STUDY IN THE PALESTINE EXCHANGE

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***Abstract*: The value relevance of comprehensive income and other comprehensive income components has examined in order to demonstrate that the explicit disclosure of comprehensive income, which came under the IAS 1 (revised 2007) improved the value of accounting information from the point of view of investors for use in decision making and whether Reflecting the economic conditions and changes of the company compared to net income. This study was based on solid research models on the relevant value and predictive capacity of the other comprehensive income and was based on statistical models developed by (Fasan et al. 2014), (Mechelli and Cimini 2014), (He and Lin 2015), (Günther 2015), which are based on the theories and concepts in this study. Thus, this study provides empirical analysis of the relevant value by looking at the correlation between market values and comparative figures and looking at the correlation between comprehensive income and other comprehensive income components with share prices and returns on equity and provides whether other comprehensive income provides the ability to predict net income Future and future cash flows. A sample of 27 Palestinian public shareholding companies was used between 2005 and 2018. The manual method of collecting these data was used through the annual financial statements and the financial statements disclosed by the companies for the period mentioned, in order to examine whether the comprehensive income is more value-relevance than net income.**

***Keywords*: Net income, Comprehensive income, other comprehensive income.**

1. INTRODUCTION

These days it is difficult to speak about the independence of the global economies, especially after the global financial crisis, so it became essential to the accounting standards setters to consider a form which provides standards that can be applied in a manner that ensures the harmonization of financial information around the world (Shambaugh et al., 2012). The need to take a position to harmonize finnancial information has strengthened efforts by the setters of accounting standards (Whittington, 2005). The future goal of IASB and IFRS is to reach one accounting standard (IASB, 2005). But the question is how, when, in what form these common standards will be and when will they be applied (Carmona and Trombetta, 2008).Many amendments to IFRS and US GAAP will be resultedfrom The convergence of different accounting. Many of these amendments will be followed by Other existing standards or adopt the IFRS application in full (Gunter, 2015). Many of the projects held in recent decades to try to reach accounting standards around the world,

including the project of convergence established by IASB and FASB, which is one of the most important projects in this field (Thinggaard et al., 2006; Whittington, 2008; Bellandi, 2012). In particular, the project's goal was focusing on presenting financial statements and information benefits and given the users of those financial statements a clear informational content (IASB, 2008b).

Starting from January 2009 companies that arrange their financial statements in consonance with IAS 1 are enforced to present their own consolidated financial statements in consonance to IAS 1 (revised 2007). In addition, another modification issued by IASB to the IAS 1 in 2011, thich contained detailes related the the other cmprehensive income presentation and does not modify the acceptance itself. Therefore, the amenedments on IAS 1 (revised 2007) are points of other comprehensive income recognition for the elements that will be convert to income statement and the perpetual which will not be converted (Gunter, 2015).

In the Statement of Financial Accounting Concepts No. 3 which issued by FASB in 1980 the comprehensive income have been defined (SFAC No. 3, 1980). The basis for this implementation came from the reality that the conventional method of income reporting was considered as very strict and the need grow for another way to show results in the financial statements.

FASB introduced in SFAS 130 (1997) the comprehensive income reporting in the late 1990s and the institutions were asked to report of comprehensive income through one of three forms:

1. Through a complementary part of the conventional income statement
2. Through a complementary part of the statement of financial position or the changes in owner's equity statement.
3. Through the "statement of comprehensive income" which is a separate financial statement.

Later on, the first form was chosen by the accounting standards setters in US and the IASB as in many of other countries (Dhaliwal et al., 1999; Pinto, 2005; Cauwenberge and Beelde, 2007; Kanagaretnam et al., 2009; IASB, 2009, 2011).

Moreover, the accounting community environment has changed significantly and the reporting about the firm's activities has become more complicated as the financial statements' users need extra details to be presented in these lists (Robinson, 1991).

The definition of the comprehensive income that approved by FASB in the concept statements No. 3 was followed by the concept of "all-included" of income for the reporting purposes (Johnson et al., 1995).

FASB's first conceptions on the comprehensive income concept reflected the general idea behind this concept, which was also adopted by the IASB in its standards. In respecting to IAS 1, the comprehensive income defined as the changing of equity in a specific period according to the transactions except that changes that occur because of the events from the changing in the ownership capacity of owners, on the other hand the comprehensive income contain all the items of profit and loss in addition to the other components (IAS 1.7).

The other comprehensive income reporting definition's main objective was to grant the users of financial statement with more inclusive, harmonious and relevant information (Cauwenberge and De Beelde, 2007; Ernstberger, 2008).

For the sake of increasing the financial information's value and consistency various methods of item's recognition were applied for both reporting in the net income statement or in the statement of comprehensive income. The decision where the item will be recognize is depend on many features (IASB, 2013c).

The elements that may distort income reporting and are identified as unrealized or non-recurring or involve uncertainty measurement and long-term or out of management domination are recorded in the statement of other comprehensive income. The elements which recorded in the income statement have the opposite characteristics. The crossing between the income statement and the balance sheet ensures that all items will be recognized in the statement of financial position in all cases. Simultaneously, certain elements which recognized directly to the other comprehensive income statement can be reclassified in later periods to the income statement (Günther, 2015).

The different handling of other comprehensive income items reclassification issue into the income statement has formed a significant embarrassment among the financial information users (Bellandi, 2012; Zhang, 2014).

Based on these facts, many investors preferred to continue using the income statement for their valuations and financial analyzes and ignored comprehensive income (Rees and Shane, 2012).

It is critical to take into account the information that provided in the other comprehensive income statement, since reliance on percentages calculated from previous data only may reduce the reporting quality (Rees and Shane, 2012).

Cauwenberge and De Beelde (2007) in their research focused on depending on net income only and discussed the issue of relying on different income measures in releasing of earning per share, and indicated that the using of two different measure of income may be grab awareness to these determinants and reinforce analyzes on the Other comprehensive income components which contain additional details.

To summarization, in order to calculate the comprehensive income the components of other comprehensive income have to be added to the net income. Despite that the net income contains all the transactions that resulted from shareholders and other transactions that represent all the profit and loss of the company in a specific time (Beale and Davey, 2001).

However, the changes in equity that have not been recorded in income statement and are not derived from transactions with the stockholders is recorded under the other comprehensive income (Ferraro and Veltri, 2012).

The success of reporting on Other comprehensive income depends mainly on the adoption and admission from the financial information preparer and users, therefore, the comprehensive income endorsement as an additional measure of income leads to the punctuality of the users of financial information because they will be obliged to take into account each component and its potential impact on the value of the institution (Günther, 2015).

Thus, the comprehensive income consists of a collection of revenues and expenses, regardless of whether it's recognized in the income statement or the statement of financial position, and without distinguishing between the ordinary or extraordinary elements (Pellens et al., 2014).

This recognition is on the basis of accrual accounting system and in consonance with International Accounting Standard No. 1.27 – 1.28, and focuses on the information and its functions in financial accounting (Pellens et al., 2014).

The components of the other comprehensive income presented to the users in the statement of other comprehensive income (Mackenzie et al., 2012).

The purpose for recording of these components in the equity because this information will be realized in other times and they have temporarily nature. However, a relevant to the company's position information provided to the investors. At the same time, they are disclosed in the other comprehensive income without any impact on the company's profit or loss. Once an interim component that classified under other comprehensive income statement has been transferred and realized, it is recorded in the income statement or compensated to retained earnings (Pellens et al., 2014).

The clean surplus accounting concept will be applied if all of the other comprehensive income components reclassified into the income statement (Boemle and Lutz, 2008; Pellens et al., 2014).

The application of income recycling standards averts the double counting and assures that whole profits and losses will eventually appear in the income statement (Mackenzie et al., 2012).

In contrast of this, the dirty surplus accounting concept permit the compensation of specific profits and losses elements that formerly recorded in the other comprehensive income statement in retained earnings when realized, and therefore a permanent excess of profit and loss (Wang et al., 2006; Isidro et al., 2006; Boemle and Lutz, 2008; Pellens et al., 2014).

From net income perspective, the permanent excess of profit or loss of certain elements of comprehensive income is a violation of the clean surplus concept (Preinreich, 1937).

The presentation of other comprehensive income in one single statement or in a separated statement is allowed by the standards' setters (Blase et al., 2010; Buschhüter and Striegel, 2011). In the case of one single statement the other comprehensive income presented in the bottom of the statement (IASB, 2008a).

In the separated statements view, the net income is consistent with the comprehensive income and there are two options for performance indicators (Cauwenberge and De Beelde, 2007).

The motivation behind the concepts described above is taken into consideration, we will always find ourselves in a trade-off between appropriateness and consistency.

The linkage to the income statement may enhance in case more elements in the other comprehensive income statement were implied, with the possibility of decreasing the comparison of the financial statements (Kanagaretnam et al., 2009).

Generally, the correlation between the income figures and the market values such as share prices and share returns show the relevance of accounting information (Barth et al., 2001; Thinggaard et al., 2006).

The correlation between market data and particular accounting information shows a correlation with the information used by investors (Francis and Schipper, 1999). However, it is significant to notice that the studied correlation does not directly correlate with causation (Kanagaretnam et al., 2009).

Several studies have examined and analyzed the correlation between various income measures and market data, including shares prices and shares returns in previous decades.

The plurality of available researches conclude that net income comparing to the comprehensive income is more closely related to market values. Moreover, the future cash flow that generated from the operations in addition to the future net income is better predicted by net income. However, the main debate was that the elements of other comprehensive income is temporary in nature (Ernstberger, 2008; Kanagaretnam et al., 2009).

Consequently, comprehensive income has a limited explanatory capacity to forecast the future operating cash flows and company's values. In these argument the existing of special elements which are non-recurrent and non-continuous at the same time and are classified as temporary in the income statement have been ignored (Burgstahler et al., 2002).

From an accounting viewpoint, it is not convincing that these numbers are processed through a different way (Jones and Smith, 2011).

The purpose of this thesis is to give an evidence empiricaly that the addition of comprehensive income and other comprehensive income components will give investors useful information help to decision-making regarding companies operating in Palestine that apply IFRS. Its expected that the information that included in the other comprehensive income will be used by the investores which will indicate that the ccomprehensive income and its othe items are value relevance in assessment and in decesion making process

This study also examines the extent to which IASB succeeded in enhancing accounting data's relevant value through the IAS 1 implementation and the the modifications to comprehensive income and its other elements disclosure.

The study included the use of robust research models to analyze the data obtained through the manual collection of data from the companies' financial statements and annual financial statements disclosed by the companies. These models are the price model which is based on linking accounting numbers and market information by linking income measures and prices. The return model, which links the income measures and shares return, has been used. The future cash flow that generated from the operation in addition to the future net income will be forecasted also in this study.

2. METHODOLOGY

This research will use empirical quantitative research approach by examining the proportional correlation between accounting numbers and market data. The proposed data collection time frame will be between 2005 and 2018 to completely cover the effect of IAS 1 amendments (revised 2007) and (revised 2011). Data will be collected using hand collected method from published financial statements for selected Palestinian listed companies from population totaled 48 -listed company.

In order to test if the other comprehensive income reporting have enhanced the value-relevance of the Palestinian company's accounting information linear regression model uses cross sectional panel data have been used.

The price model approach has been utilized to assess the correlation between measures of income with share prices. The application of return model came to evaluate the correlation between share returns income measures. Furthermore, the forecasting regression model was applied to test the income measures' predictability of the future net income and future operating cash flows. The model that used to examine the research questions and hypotheses in the previous section has been further explained in subsequent sections.

The first impression is based on the topics discussed before which is the temporarily nature of the comprehensive income and its other components. Therefore, random walk model is expected to be used and returned over time, so it should be expected to find zero values. Chambers et al. (2007)

Consequently, the net income should be more correlated to the market values than the comprehensive income. Furthermore, the comprehensive income considered as a deforming factor of financial information by some investors, so it cannot be included in the decision making process and valuation by investors (Gunter, 2015).

Based on these considerations and discussions, the first question of this research was formulated as follows:

[RQ1]: Does reported comprehensive Income, deliver value-relevant information related to net income?

As an answer to the first question, other comprehensive income elements can provide relevant information to the investors.

The second question of the research questions is whether the market values is correlated with other comprehensive income added to the net income than the stand alone net income

Based on these considerations and discussions, the second question of this research was formulated as follows:

[RQ2]: Do comprehensive income and other comprehensive income components provide more value-relevant information compared to net income?

By taking into account the temporary nature of other comprehensive income components it assumed that these components have no predicting ability of the future net income or future operating cash flow. According to that the net income has a higher predictability than the comprehensive income. According to that our third questions has been developed.

[RQ3]: Do the forecasting ability increased by the comprehensive income and the Other Comprehensive Income components compared to the Net Income?

It is significant also to determine if the implementation of IAS-1 in 2007 and with the effective date starting from January 2009 which included a modification to the presentation of the comprehensive income has increase the value relevance of comprehensive income. According to that the fourth question was discussed as follows:

[RQ4]: Has the value-relevance of Comprehensive Income increased after applying of IAS-1 (revised 2007)?

Statement of hypotheses

Based on this research objectives, which were formulated in the research questions, the following hypotheses were formulated for studying these questions and to obtain the results in order to provide an appropriate answers for the research questions. The developed hypotheses are defined as following:

[H1]: Comprehensive Income (on a consolidated basis including components of Other Comprehensive Income) is stronger correlated with share prices than Net Income.

[H2]: Comprehensive Income (on a consolidated basis including components of Other Comprehensive Income) is stronger correlated with share returns than Net Income..

[H3]: Current Comprehensive Income (on a consolidated basis including components of Other Comprehensive Income) is a better predictor of future Operating Cash Flows and future Net Income than current net income.

[H4]: The correlation of Comprehensive Income and other comprehensive components with shares price and share returns has increased after the implementation of IAS 1 (revised 2007).

Linear regression models with a cross sectional and panel data analysis will be applied in order to examine the value relevance of the Income measures. Depending on many prior researches such as, (Fasan et,, al. 2014), (Cimini and Mechelli 2014), (He and Lin 2015), (Günther 2015) both of price model and return model will be used in this study. The price model uses price level as dependent variable and investigate its relation with different income measures to test [H1]. While, return model analyses the correlation between annual return per share and accounting numbers to test [H2]. The research makes the using of adoption of standing well established models in different research areas with some

modifications to existing models to be appropriate for our research objectives. And to test [H3] forecasting models used to analyze the predictability of certain accounting numbers. And to test if there is an effect on the correlation between accounting numbers and market values after applying of IAS 1 (revised 2007), Chow tests applied to test [H4].

3. RESULTS

In this section the result from the regression models which analyzed the correlation between the accounting number and the market value and the results from forecasting models will be presented.

Results of Price Regressions

The price model outcomes show that NI is more value-relevance than CI and OCI, unless the difference is insignificant because the adjusted R-squared for NI, CI and OCI was 0.679, 0.669 and 0.679 respectively.

The results from testing the first Hypotheses [H1], this section will show the correlation between NI, CI and OCI and the share prices.

Based on using the fixed effect regression model as panel data model the adjusted R-squared for all model were around 67%, which is predicted because the regression model is based on the BVE (Kanaagaretnam et al., 2009; Höhn, 2011; Deol, 2013). The coefficients for the independent variables BVE, NI and CI were positive and highly significant at $P<0.01$ except OCI which was negative. And based on the criteria that used to compare between the models which is the adjusted R-squared, it's obvious that the models contain NI are preferred over those with CI, and the model that contain OCI is preferred over that depended only on CI.

To test [H4] if the correlation between CI and OCI and share price was affected by IAS 1 (revised 2007) implementation the Chow Test applied. The Chow Test shows that the interaction between the two periods Pre-IFRS and Post-IFRS shows that the implementation of IAS 1 (revised 2007) had affected the correlation between the CI and share price.

Results of Return Regressions

The return model results show that NI is more value-relevance than CI and OCI, also the adjusted R-squared for NI, CI and OCI was 0.6609, 0.6112 and 0.6598 respectively.

The results from testing the second Hypotheses [H2], this section will show the correlation between NI, CI and OCI and the share returns.

Based on using the fixed effect regression model as panel data model the adjusted R-squared for all model were ranged between 61% for the model included CI to 65% for the models included NI. The coefficients for the independent variables NI and CI were positive and highly significant at $P<0.01$ except OCI which was negative. And based on the criteria that used to compare between the models which is the R-squared, it's obvious that the models contain NI are preferred over those with CI, and the model that contain OCI is preferred over that depended only on CI.

To test [H4] if the correlation between CI and OCI and share return was affected by the IAS 1 (revised 2007) implementation the Chow Test applied. The Chow Test shows that the interaction between the two periods Pre-IFRS and Post-IFRS shows the applying of the IAS 1 (revised 2007) had affected the correlation among CI and share returns.

Results of forecasting models

As mentioned in former sections the users especially the investors are not interested only in the correlation between market data and accounting numbers, but also with the predictive power and the forecasting ability of these information.

Forecasting Operating Cash Flows Regressions

The forecasting operating cash flows regression results show that CI does not have further forecasting ability compared to NI. The adjusted R-squared for NI, CI and OCI was 0.176, 0.170 and 0.175 respectively.

The results from testing the third Hypotheses [H3], this section will show the correlation between NI, CI and OCI with the future operating cash flows.

Based on using the fixed effect regression model as panel data model the adjusted R-squared for all model were around 17%. The coefficients for the independent variables NI and CI were positive and highly significant at P<0.01 except OCI which was negative. And based on the criteria that used to compare between the models which is the R-squared, it's obvious that the models contain NI are preferred over those with CI, and the model that contain OCI is preferred over that depended only on CI.

To test [H4] if the correlation between CI and OCI and forecasting operating cash flows was affected by the IAS 1 (revised 2007) implementation the Chow Test applied. The Chow Test shows that the interaction between the two periods Pre-IFRS and Post-IFRS shows that the implementation of the IAS 1 (revised 2007) had affected he correlation between the CI and operating cash flows.

Forecasting Net Income Regressions

The forecasting net income regression results show that NI is better than of CI as an indicator of current NI. The adjusted R-squared for NI, CI and OCI was 0.9575, 0.9090 and 0.9574 respectively.

The results from testing the third Hypotheses [H3], this section will show the correlation between Net Income, Comprehensive Income and Other Comprehensive Income and future net income.

On the basis of the fixed effect regression model as panel data model the adjusted R-squared for all model were ranged between 90% for the model included CI to 95% for the models included NI. The coefficients for the independent variables (NI, CI and OCI) were positive and highly significant at P<0.01. And based on the criteria that used to compare between the models which is the R-squared, it's obvious that the models contain NI are preferred over those with CI, and the model that contain OCI is preferred over that depended only on CI.

To test [H4] if the correlation between CI and OCI and forecasting net income was affected by IAS 1 (revised 2007) implementation the Chow Test was applied. The Chow Test shows that the interaction between the two periods Pre-IFRS and Post-IFRS shows that the IAS 1 (revised 2007) application had affected the correlation between the CI and forecasting net income.

4. DISCUSSION

This article included an empirical study on the relationship of income measures namely the relationship of NI, CI and OCI with the market data of companies like share prices and share returns. It also included a study of the income measures' predictive power in predicting of the future cash flows from operations and future net income. It is worth noting that the statistical differences between the income measures were not significant and were judged by which one a higher adjusted R has squared.

The price model was applied to examine the first hypothesis [H1], which stated that CI, including OCI, is more correlated with share prices than NI. Subsequent to studying and analyzing the financial data and information obtained from the Palestinian Stock Exchange, the results indicated that NI is more correlated with the share prices compared to the CI, thus the first hypothesis was rejected.

The return model was applied to examine the second hypothesis [H2], which stated that CI, including OCI, is more closely correlated with share returns than NI. Subsequent to the studying and analyzing of the financial data and information obtained from the Palestinian Stock Exchange, the results indicated that the net income is more correlated with the share returns compared to the comprehensive income, thus rejecting the second hypothesis.

The correlation between income measures and predictability of future operating cash flows and future net income was examined to test the Third hypotheses [H3]. The results indicated that the NI has more predictable of future operating cash flows and net income than the CI, thus rejecting the third hypothesis.

Chow test was applied to examine whether the correlation between the CI and OCI and the share prices and share returns increased after the implementation of IFRS to test the fourth hypotheses [H4]. The results indicated that the correlation has increased and the value relevance and the predictive power of CI and OCI have increased after applying of IFRS, thereby accepting the fourth hypothesis.

5. LIMITATIONS AND RECOMMENDATIONS

The preparing process of this thesis faced many of limitations started from the collecting of the data manually from the companies' financial statements and choosing the sample from the company in the way that appropriate to the period 2005-2018. The obtaining of financial information for the companies that related to the previous periods before the application of IFRS was hard because not all of companies disclosed the annual financial statement online so the contacting with the Palestine Capital Market for getting the information.

The emerging countries, including Palestine should work to communicate with the IASB and reporting needs related to accounting standards and financial reporting accounting, which could be taken into consideration by the IASB to take action and make amendments to some of the criteria in line with the economic environment of the emerging countries.

The need for the commitment of the Palestinian companies to apply International Financial Reporting Standards and the government should enact legislation and issuing laws that support the application of corporate standards while taking into account the changes in the Palestinian environment.

Activate the role of professional accounting associations in Palestine and activate their role in providing scientific references and books that are in line with the ongoing accounting and professional developments, in addition to holding educational seminars and conferences that educate accountants and auditors about their professional role and train them on the practices and applications of new standards.

Urging the official authorities responsible for companies listed on the PSE, such as the Securities Commission and the Companies Control Department, to raise the awareness of corporate departments on the importance of the concept of other comprehensive income.

Urging the management of public shareholding companies to revalue their fixed assets and disclose the differences resulting from other comprehensive income items as they are an important part of their capital and this has an important impact for different stakeholders and the quality of profit disclosure.

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