

RECOGNITION OF COMPREHENSIVE INCOME IN SLOVAK COMPANIES

Marta Lapková

Ing., Mgr., PhD

Matej Bel University, Faculty of Economics

Department of Finance and Accounting

E-mail: Marta.Lapkova@umb.sk

Jana Stašová

Ing., PhD

Matej Bel University, Faculty of Economics

Department of Finance and Accounting

E-mail: Jana.Stasova@umb.sk

Financial statements are the key resource for assessing a company's performance. The form and content of financial statements reflect a country's accounting regulations. If financial statements can be drawn up under a range of different principles and procedures, this may cause problems for external users. The purpose of this paper is to evaluate comprehensive income recognition in the financial statements of Slovak companies that are prepared according to IFRS, with an emphasis on items of other comprehensive income.

Keywords: *financial statements, comprehensive income, other comprehensive income.*

Introduction

Despite current efforts to measure business performance by various combinations of financial criteria, income is still the most important indicator in evaluating an enterprise's performance. The key information resource for evaluating business performance for external users are financial statements. The form and content of the financial statements are affected by a country's accounting regulations, for these set the rules for providing financial information to external users. If a variety of different principles and procedures may be used in preparing financial statements, then this may cause problems for users making economic decisions. Therefore comparability has become one of the main objectives for creators of accounting standards, and is the main reason for establishing International Financial Reporting Standards (IFRS). IFRS have become an appropriate tool for achieving comparability of financial statements across the world, and a growing number of countries require their application. Despite long-standing efforts to harmonize Slovak accounting legislation with IFRS, there are

still significant differences between the two systems, and these differences cause problems in analyzing and resolving economic problems.

The object of the research is the concept of the comprehensive income of business enterprises.

The purpose of the research is to evaluate the recognition of comprehensive income in the financial statements of Slovak companies, with an emphasis on the concept of other comprehensive income.

The methods of the research are the following: an analysis of the scientific literature and of the financial statements of selected Slovak companies, and the systematization, comparison and generalization of information.

1. Recognition of Comprehensive Income in the Financial Statements

One of major projects of the International Accounting Standards Board (IASB) aimed at improving the usefulness of the financial information provided in financial statements is *The Financial Statements Presentation Project*. The results of this project were the amendments to IAS 1 *Presentation of Financial Statements* and its last amendment in June 2011, which changed the presentation of the other comprehensive income.

Other comprehensive income comprises items of income and expenses (including reclassification adjustments) that are not recognized in profit or loss as required or permitted by other IFRSs. The components of other comprehensive income include (IAS 1):

- a. Changes in revaluation surplus (see IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*);
- b. Re-measurements of defined benefit plans (see IAS 19 *Employee Benefits*);
- c. Gains and losses arising from translating the financial statements of a foreign operation (see IAS 21 *The Effects of Changes in Foreign Exchange rates*);
- d. Gains and losses from investments in equity instruments measured at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9 *Financial Instruments*;
- e. The effective portion of gains and losses on hedging instruments in cash flow hedge, and the gains and losses in hedging instruments that hedge investments in equity instruments, measured at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9 (see Chapter 6 of IFRS 9);
- f. For particular liabilities designated as at fair value through profit or loss, the amount of the change in fair value that is attributable to changes in the liability's credit risk (see paragraph 5.7.7 of IFRS 9);
- g. Changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value (see Chapter 6 of IFRS 9);
- h. Changes in the value of the forward elements for forward contracts when separating the forward element and spot element of a forward contract, and designating as the hedging instrument only the changes in the spot element,

and changes in the value of the foreign currency basis spread of a financial instrument as the hedging instrument (see Chapter 6 of IFRS 9).

The above items must be classified into those that (Mackenzie et al., 2013):

- will not be reclassified subsequently to profit or loss; or
- will be reclassified subsequently to profit or loss.

An entity may present a single *Statement of profit or loss and other comprehensive income* (hereinafter referred to as a statement of comprehensive income) with profit or loss and other comprehensive income presented in two sections (Table 1), or in two separate statements – a statement of profit or loss and a statement of comprehensive income which begins with profit or loss.

Table 1. Statement of Profit or Loss and Other Comprehensive Income

Statement of profit or loss and other comprehensive income		
Revenues	<i>Profit or loss</i>	
Expenses arising in the course of the ordinary activities of the entity		
Gains recognized in profit or loss		
Losses recognized in profit or loss		
<i>Profit or loss</i> ¹		
Gain and losses not recognized in profit or loss classified by their nature (including the share of the other comprehensive income of associates and joint ventures accounted for using the equity method)	not reclassified subsequently to profit or loss	<i>Other comprehensive income</i>
	reclassified subsequently to profit or loss when specific conditions met	
<i>Total other comprehensive income</i>		
<i>Total comprehensive income for the period</i> ²		<i>Comprehensive income</i>

Source: compiled by the authors

An entity can present expenses recognized in profit or loss using a classification based on either their nature or their function within the entity, whichever provides information that is reliable and more relevant (IAS 1).

Items of other comprehensive income could be presented either net of related tax effects or before related tax effects, with one amount shown for the aggregate amount of income tax relating to those items (IAS 1).

2. Analysis of Comprehensive Income Recognition in Slovak Companies

Unlike IFRS Slovak entities do not prepare statements of comprehensive income as a part of financial statements. They only have to prepare a profit or loss

¹ Profit or loss is the total income less expenses, excluding the components of other comprehensive income (IAS 1).

² Comprehensive income is the change in equity during a period resulting from transactions on other events, other than those changes resulting from transactions with owners in their capacity as owners (IAS 1).

statement whose structure is stipulated in the Decree of the Finance Ministry of the Slovak Republic No. 4455/2003-92 as amended. This decree lays down details on the structure, description and content of items in individual financial statements, and the extent of the data contained in individual financial statements, to be published by entrepreneurs maintaining accounts under the system of double entry book-keeping.

Since 2005, all consolidated financial statements of Slovak accounting entities must be prepared according to IFRS. Since 2006, selected accounting entities are required to prepare their individual financial statements according to IFRS instead of Slovak legislation (Article 17a (1) of the Act. No. 431/2002 Coll. on Accounting as amended). This amendment applies to approximately 150 accounting entities¹ (Farkaš, 2013). The subject of our research was a sample of 58 financial statements of these companies for the period 2012 which are publicly available on the internet. We divided them into three groups – financial institutions, production and trade companies and service companies. We examined their financial statements in terms of the following formal requirements (Table 2):

- The form of the statement of profit or loss and other comprehensive income (CI statement) – were there one or two statements?
- The form of the statement of profit or loss (P/L statement) – was the classification based on the nature or the function of expenses?
- The reporting of other comprehensive income (OCI) – was it before or after tax?

Table 2. Form of Comprehensive Income Reporting

Type of entity	No.	Form of CI statement		Form of P/L statement		Items of OCI		
		1 stat.	2 stat.	Based on nature	Based on function	No item	After tax	Before tax
Financial institutions	21	12	9	17	4	3	7	11
Production and trade companies	16	15	1	11	5	12	4	0
Service companies	21	15	6	17	4	11	10	0
Total	58	42	16	45	13	26	21	11

Source: compiled by the authors

Table 2 indicates that a majority of entities (72%) prepare statements of comprehensive income as a single statement, consisting of two sections – a profit

¹ Banks, branches of foreign banks, the Export-Import Bank of the Slovak Republic, administration companies and branches of administration companies, insurance companies, except for health insurance companies, and branches of foreign insurance companies, reinsurance companies and branches of reinsurance companies, the Slovak Office of Insurance Traders, pension management companies, supplementary pension management companies, the Slovak Exchange, the Railroads of the Slovak Republic, a payment institution, and companies that exceeded at least two of the three criteria of size (net turnover EUR 165,969,540. 40; gross assets EUR 165,969,540. 40; and 2,000 employees) for at least two successive accounting periods.

or loss section and a section on other comprehensive income. Most entities (78%) prepare their statements of profit or loss based on the nature of expenses rather than on their function within entities. A small majority of entities (55%) recognize in their statement of comprehensive income some items of other comprehensive income, and two out of three of them (66%) recognize these items after tax.

We then focused on items of other comprehensive income and their impact on the recognized profit or loss of entities (Table 2). As we have already mentioned, gains and losses not recognized in profit or loss will be, or will not be reclassified subsequently to profit or loss, so we examine how these reclassified items would affect reported profit or loss. Most of the investigated entities (86%) reported a profit in 2012 and more than a half of these companies (62%) recognized some items of other comprehensive income. Only 14% of entities reported a loss and 63% of them recognized other comprehensive income.

Table 3. Impact of Other Comprehensive Income on Profit or Loss

Type of entity	Entities reporting profit or loss		
	No impact	Increase	Decrease
Financial institutions	11	9	1
Production and trade companies	11	2	3
Service companies	18	1	2
Total	40	12	6

Source: compiled by the authors

Table 3 indicates that for most of the entities (69%) other comprehensive income has not had any impact on the reported profit or loss. However if we only consider items of other comprehensive income that will be reclassified in the profit and loss statement in the next reporting period, then the results vary by type of entity. Most financial institutions (90%) would record higher income, but a majority of other entities (63%) would record lower income.

Financial statements are a major information resource for analysts assessing an entity's financial situation. Financial analysis reduces the uncertainty of such assessments. A fundamental choice is the selection of financial-economic indicators, and profit or loss is a key component of several commonly used indicators. For our research we selected two basic indicators of profitability – Return on Equity (ROE) and Return on Assets (ROA), and we examined the effect of reclassifying other comprehensive income items on these indicators (ROEr, ROAr).

$$ROE = (\text{net income}/\text{equity}) \times 100$$

$$ROA = (\text{net income}/\text{Assets}) \times 100$$

$$ROEr = [(\text{net income} + \text{reclassified OCI})/\text{equity}] \times 100$$

$$ROAr = [(\text{net income} + \text{reclassified OCI})/\text{assets}] \times 100$$

Reclassified items of comprehensive income have impact on the selected indicators only for financial institutions (Figure 1).

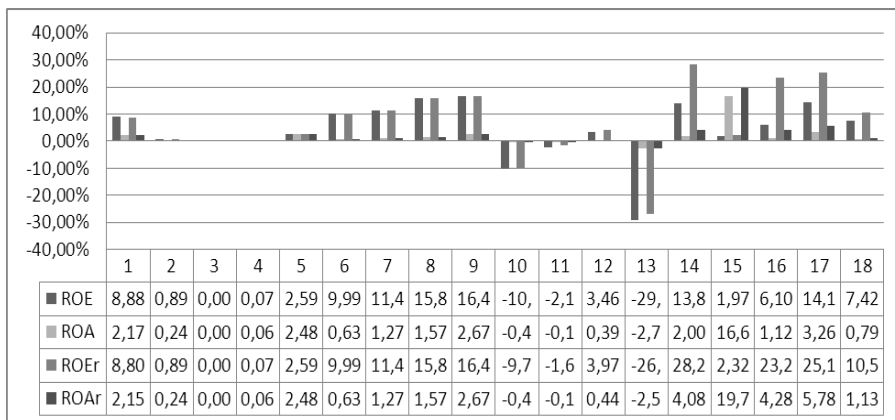


Figure 1. Effect of Other Comprehensive Income on ROE and ROA

Compiled by the authors

Figure 1 shows analysis results of 18 entities from the group of financial institutions, which reported some items of other comprehensive income. Figure 1 indicates that in more than half the cases (56%) items of other comprehensive income caused a change in the selected indicators. In other groups, production and trade companies and service companies, most entities (62%) did not recognize other comprehensive income, and if they did recognize them then they had not any effect on the selected indicators.

Conclusion

Financial statements should provide useful and reliable information for the assessment of a company's financial situation. Both the form and content of financial statements are affected by a country's accounting regulations. Therefore users of financial statements should familiarize themselves with these regulations before taking major decision based on financial statements. Our research showed that Slovak companies preparing financial statements in accordance with IFRS use a range of options allowed by national standards. Therefore the form of their comprehensive income recognition varies. Other comprehensive income was recognized in the statement of profit or loss and other comprehensive income, in the majority of researched entities. Our research shows that reporting of other comprehensive income divided into reclassified and not reclassified items is relevant for the assessment of company performance, because of their impact on reported profit or loss, and on selected indicators of profitability, particularly for our sample of financial institutions. This is due to the nature of their activity, for in most cases the gains and losses on financial assets available for sale are recognized in other comprehensive income, which will be reclassified to profit or loss in subsequent periods.

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Summary

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The purpose of this paper is to evaluate comprehensive income recognition in the financial statements of Slovak companies that are prepared according to IFRS, with an emphasis on items of other comprehensive income.

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