Reporting Preferences under the Comprehensive Income Standard

Examining Its Use in Practice

By Charles E. Jordan and Stanley J. Clark

Effective in 1998, Statement of Financial Accounting Standards (SFAS) 130, *Reporting of Comprehensive Income* [now Accounting Standards Codification (ASC) Topic 220, "Comprehensive Income"], required that companies report comprehensive income and its components in a financial statement that is given equal prominence with other financial statements. In the exposure draft to the standard, FASB proposed reporting comprehensive income on a performance-based financial statement prepared using one of two alternatives: 1) a continuous statement of income with the top part being a traditional income statement leading to the determination of net income, and the items of other comprehensive income (OCI) serving as adjustments to net income in order to derive a bottom-line number (i.e., comprehensive income), or 2) a freestanding statement of comprehensive income that begins with net income, adjusted for the OCI items in order to arrive at comprehensive income.

One frequent comment on this exposure draft by financial statement preparers conveyed the belief that presenting comprehensive income in either of these two formats would confuse users, who would be unable to discern which income number best reflected an entity's operating performance. FASB relented to this pressure by allowing a third option in SFAS 130: the computation and presentation of comprehensive income in the statement of changes in shareholders' equity. This alternative, dubbed the non-performance-based option, essentially permitted comprehensive income to be buried in a relatively obscure financial statement.

Following the implementation of SFAS 130, numerous studies showed that the non-performance-based alternative prevailed in practice. For example, an examination of financial service firms in the initial year of adoption revealed that 63% of the sample companies reported comprehensive income in the statement of changes in shareholders' equity, whereas 25% used a separate statement of comprehensive income and only 12% presented a continuous statement of income that included the computations of both net income and comprehensive income (Charles Jordan and Stanley J. Clark, "Comprehensive Income: How Is It Being Reported and What Are Its Effects?," *Journal of Applied Business Research*, vol. 18, no. 2, 2002, pp. 1–8). A later study examined a randomly selected sample of 100 companies listed on the New York Stock Exchange (NYSE); it found that 89 companies reported comprehensive income in the statement of changes in shareholders' equity, 9 reported it in a separate statement, and only 2 reported it in a continuous statement with net income (Ganesh Pandit and Jeffrey Phillips, "Comprehensive Income: Reporting Preferences of Public Companies," *The CPA Journal*, November 2004, pp. 40–41).

But FASB still believed that items of OCI, while not affecting traditional net income, impacted a company's financial performance and should be reported as such; thus, in 2011, the board issued Accounting Standards Update (ASU) 2011-05, *Presentation of Comprehensive Income*, which eliminated the option of reporting comprehensive income in the statement of changes in shareholders' equity. For fiscal years beginning after December 15, 2011, public entities had to report items of OCI and comprehensive income in one of the two performance-based options originally provided in the exposure draft to SFAS 130. FASB delayed implementation of ASU 2011-05 one year for nonpublic companies (i.e., until fiscal years beginning after December 15, 2012).

For most public companies, 2012 represented the first year of reporting comprehensive income in accordance with ASU

2011-05. This article's authors looked at a randomly selected sample of 250 of the *Fortune* 1000 in order to determine how companies reported comprehensive income in the initial year of adoption and whether the reporting format chosen was related to any particular financial characteristics of the entities. In addition, the authors present descriptive statistics concerning the four main OCI items affecting the determination of comprehensive income.

Current Reporting Requirements

The elimination of the non-performance-based reporting option represents the primary difference between ASU 2011-05 and SFAS 130. A secondary difference relates to the placement of the separate statement of comprehensive income within a complete set of financial statements—SFAS 130 did not stipulate the placement, whereas ASU 2011-05 dictates that it must appear immediately after the traditional income statement. The continuous statement approach tacks the computation of comprehensive income onto the bottom of the traditional income statement; under the separate statement approach, net income serves as the starting point and is then adjusted for the items of OCI to determine comprehensive income. Previous articles in *The CPA Journal* provide good examples of these two reporting options (e.g., Dennis J. Chambers, "Comprehensive Income Reporting: FASB Decides Location Matters," September 2011, pp. 22–25; Tim V. Eaton, Kathryn E. Easterday, and Michael R. Rhodes, "The Presentation of Other Comprehensive Income: FASB's Recent and Proposed Changes," March 2013, pp. 32–35).

ASU 2011-05 also states that under both reporting options, each main item of OCI must be reported separately. It made no changes to the components of OCI (the four primary ones being gains and losses from foreign currency translation adjustments, unrealized holding gains and losses on available-for-sale securities, gains and losses from cash flow hedges, and various items affecting the fair value of plan assets and projected benefit obligation relative to defined-benefit pension plans). These individual OCI items may be presented on a gross or net of tax basis. If reported gross, the aggregate tax expense or benefit for all OCI items must be presented as a separate line item in the computation of comprehensive income.

FASB prohibits reporting per-share amounts for either the items of OCI or comprehensive income. Furthermore, ASU 2011-05 does not address the presentation of per-share amounts for net income and its various components.

Prior Reporting Biases

Research suggests that, when applying SFAS 130, management tended to be somewhat biased in choosing a reporting format for comprehensive income, with numerous factors influencing its decision. For example, one study examined 82 publicly traded liability insurers and found that companies that managed earnings by cherry-picking their securities to create realized gains were more likely to present comprehensive income in the statement of changes in shareholders' equity than other companies (Yen-Jung Lee, Kathy Petroni, and Min Shen, "Cherry

EXHIBIT 1

Dex One Corporation
Consolidated Statement of Comprehensive Income
(in thousands, except per-share amounts)

Net revenues	$1,300,009
Expenses:	
Production and distribution expenses	283,651
Selling and support expenses	344,540
General and administrative expenses	127,437
Depreciation and amortization	418,652
Total expenses	1,174,280
Operating income	125,729
Gain on debt repurchase, net	139,555
Interest expense, net	(195,959)
Income before income taxes	69,325
Provision for income taxes	(6,924)
Net income	62,401
Other comprehensive income (loss):	
Benefit plan adjustment, net of tax provision	(16,461)
Total other comprehensive income (loss)	(16,461)
Comprehensive income (loss)	$ 45,940
Earnings per share:	
Basic	$1.23
Diluted	$1.23
Shares used in computing earnings per share:	
Basic	50,643
Diluted	50,643

Note: The above statement is adapted from comparative statements in the 10-K report to reflect 2012 results only.

EXHIBIT 2

BMC Software Incorporated
Consolidated Statement of Comprehensive Income
(in millions, except per-share amounts)

Revenue:	
License	$ 838.5
Maintenance	1,139.1
Professional services	223.8
Total revenue	2,201.4
Operating expenses:	
Cost of license revenue	159.6
Cost of maintenance revenue	208.4
Cost of professional services revenue	224.0
Selling and marketing expenses	686.9
Research and development expenses	174.6
General and administrative expenses	238.7
Amortization of intangible assets	43.8
Total operating expenses	1,736.0
Operating income	465.4
Other income (expense), net:	
Interest and other income, net	8.3
Interest expense	(47.8)
Gain (loss) on investments, net	2.0
Total other expense, net	(37.5)
Earnings before income taxes	427.9
Provision for income taxes	96.9
Net earnings	$ 331.0
Basic earnings per share	$2.17
Diluted earnings per share	$2.13
Shares used in computing basic earnings per share	152.7
Shares used in computing diluted earnings per share	155.7
Net earnings	$ 331.0
Other comprehensive income (loss):	
Foreign currency translation adjustment, net of $3.3 tax benefit	(.3)
Unrealized gain on available-for-sale securities, net of $.1 tax benefit	.7
Unrealized loss on cash flow hedge, net of $.1 tax benefit	(.3)
Total other comprehensive income (loss)	.1
Total comprehensive income	$ 331.1

Note: The above statement is adapted from comparative statements in the 10-K report to reflect 2012 results only.

Picking, Disclosure Quality, and Comprehensive Income Reporting Choices: The Case of Property-Liability Insurers," *Contemporary Accounting Research*, vol. 23, no. 3, 2006, pp. 655–692). Having managed earnings to desired levels, managers presumably did not want users associating OCI items with earnings and accordingly distanced the presentation of comprehensive income from net income.

A study of 73 early adopters of SFAS 130 found that companies reporting comprehensive income in one of the two performance-based formats tended to have positive OCI items; conversely, companies with predominately negative OCI items opted to report comprehensive income in the statement of changes in shareholders' equity (Linda Campbell, Dean Crawford, and Diana Franz, "How Companies are Complying with the Comprehensive Income Disclosure Requirements," *Ohio CPA Journal*, vol. 58, no. 1, 1999, pp. 13–20). In the study discussed earlier, Jordan and Clark discovered a similar relationship between the sign of the OCI items and the reporting format chosen: only 19% of the companies reporting comprehensive income in one of the two performance-based formats had negative total OCI, whereas more than 46% of the companies reporting comprehensive income in the statement of changes in shareholders' equity had negative total OCI. Jordan and Clark also found that the amount or magnitude of the total OCI items differed between the two groups. After normalizing total OCI for entity size, they determined that the performance-based group reported significantly larger OCI items than the non-performance-based group.

As demonstrated, research conducted during the SFAS 130 era suggests that certain financial characteristics affected the choice of reporting format for comprehensive income. Because the non-performance-based alternative (i.e., reporting comprehensive income in the statement of changes in shareholders' equity) no longer exists under ASU 2011-05, the question is whether the choice of reporting option continues to be influenced by these financial traits.

A Review of the Findings

Reporting preferences. To determine reporting preferences under the comprehensive income standard, 250 entities with fiscal years beginning after December 15, 2011, were randomly selected from the list of *Fortune* 1000 companies. The companies' 2012 audited financial statements were obtained from their 10-K reports, available on the SEC's Electronic Data Gathering, Analysis, and Retrieval (Edgar) database. Of the 250 companies, 32 (12.8%) utilized a continuous statement of income and 218 (87.2%) utilized a separate statement of comprehensive income.

Given the strong tendency for entities to report comprehensive income in the statement of changes in shareholders' equity under SFAS 130, the reporting choice under ASU 2011-05—reporting comprehensive income as far away as possible from the determination of net income—

The authors suggest that FASB issue specific guidance on the placement of EPS information within the continuous statement format.

comes as no surprise. Under ASU 2011-05, the separate statement format provides more distance between the computations of net income and comprehensive income than the continuous statement presentation would.

An interesting phenomenon became apparent among companies that chose the continuous statement format. In essence, two versions of this format emerged. In one version, net income was determined in the normal manner. The statement then transitioned smoothly into the computation of comprehensive income, with net income as the starting point. The display of earnings per share (EPS) information occurred at the very bottom of the statement (i.e., following the presentation of comprehensive income). Of the 32 companies choosing the continuous statement option, 15 used this format. *Exhibit 1* provides the 2012 income statement for Dex One Corp., a typical example of this method.

The second version also began with the determination of net income in the traditional manner; however, EPS information appeared before the computation of comprehensive income. Then, the net income figure occurred again and served as the starting point for the computation of comprehensive income. The EPS information effectively separated the computations of net income and comprehensive income. Of the 32 companies using the continuous statement format, 17 employed this approach. *Exhibit 2* provides the 2012 income statement for BMC Software Inc., a typical example of this method.

The placement of EPS information represents the main difference between these two variations. ASU 2011-05 does not prescribe the exact format that must be used for the continuous statement, nor does it state where EPS information should be presented within the statement. ASC 220-10-55-7, however, does provide examples for both the continuous and separate statement options. In the ASC example for the continuous statement, FASB placed EPS information immediately after net income and before the computation of comprehensive income. Interestingly, the example contains only one line for EPS (i.e., both basic EPS and diluted EPS are the same number and appear on a single line, with no information provided on the number of shares used in the EPS computation); thus, FASB made an extremely brief and perhaps overly simplified presentation of EPS information in its example, unlike the rather involved EPS presentation seen in *Exhibit 2*. In addition, BMC Software's continuous statement reports net income a second time (i.e., after the EPS information and at the start of the comprehensive income computation), whereas FASB's example presents net income only once (as the final number in the determination of net income and the starting point for the computation of comprehensive income). Most of the 17 companies placing EPS information between net income and comprehensive income in the continuous statement format did so in a manner similar to BMC Software.

A legitimate argument could be made for placing EPS information immediately after net income because EPS specifically relates to net income and not to comprehensive income; however, it seems that placing EPS information (especially if that information is somewhat detailed) at the bottom of the statement aligns more closely with FASB's notion of presenting a seamless computation of comprehensive income. To improve the comparability of financial reporting, the authors suggest that FASB should issue specific guidance on the placement of EPS information within the continuous statement format.

Factors affecting reporting choice. The authors examined sample companies' key financial characteristics to ascertain any patterns in the reporting choice for comprehensive income under ASU 2011-05. First, entity size was evaluated by segregating the sample of companies based on total revenue as the measure of entity size, comparing the largest 125 companies with the smallest 125. Although the group of smaller companies yielded a slightly higher incidence of the continuous statement format (16%)

than the group of larger companies (9.6%), this difference was not material using traditional levels of statistical significance (i.e., chi-square test statistic of 2.294 producing a p-level of .130).

Prior research showed that the sign of the total OCI items was associated with the reporting preference for comprehensive income under SFAS 130, with companies reporting negative OCI tending toward the statement of changes in shareholders' equity and companies with positive OCI opting for a performance-based report. For the current sample, 104 (41.6%) of the companies reported negative total OCI, and 146 (58.4%) generated positive total OCI. Thirteen (12.5%) of the negative OCI companies reported comprehensive income in a continuous statement, while 19 (13%) of the positive OCI entities used this format. Thus, there was virtually no difference in the reporting choice based on the sign of total OCI (i.e., chi-square test statistic of .014 producing a p-level of .905).

Previous research under SFAS 130 also indicated that the relative size or magnitude of total OCI affected the reporting decision for comprehensive income; entities that produced more significant amounts of OCI tended toward a performance-based report and companies with smaller relative amounts of OCI preferred the non-performance-based statement. To determine the relative magnitude of total OCI for each company in the current sample, total OCI was divided by that company's revenue. This resulted in a median amount of OCI to revenue in terms of absolute value of .0037 (or .37%).

The sample was then segregated into two groups based on this measure of OCI magnitude (i.e., one group was composed of the 125 companies with OCI to revenue above .37%, while the other group was composed of the 125 entities with OCI to revenue below .37%). Of the former group, 19 companies (15.2%) reported comprehensive income in a continuous statement, whereas 13 (10.4%) of the latter group chose this option. Although some difference in the reporting choice existed based on the relative size of total OCI, tests revealed that it was not statistically significant (i.e., chi-square test statistic of 1.25 producing a p-level of .256).

The final trait examined was operating performance, or profitability, as measured by profit margin (i.e., net income divided by net revenue). The median profit margin of all the companies was 5.54%. The 125 entities with profit margins above this amount made up one group, and the 125 companies with profit margins below 5.54% made up a second group. A comparison of the reporting preferences between these two groups appears in *Exhibit 3*. Only 10 (8%) of the 125 top-performing companies presented comprehensive income in a continuous statement; however, the 125 bottom-performing companies chose a continuous statement format more than twice as often (i.e., 22,

EXHIBIT 3
Reporting Preferences by Operating Performance

Reporting format	Profit Margin: Bottom performers	Profit Margin: Top performers
Continuous statement of income	22 (17.6%)	10 (8.0%)
Separate statement of comprehensive income	103 (82.4%)	115 (92.0%)
Total	125 (100%)	125 (100%)

Chi-square test statistic = 5.161

p-level = .023

EXHIBIT 4
Summary Statistics for OCI Items

	Available for Sale Securities	Foreign Currency Translations	Cash Flow Hedges	Pensions	Other	Total OCI
Number of companies	122	183	157	174	18	250
Mean amount (in millions)	119.1	24.8	11.7	–142.5	–0.8	–11.4
Median amount (in millions)	1.0	5.3	1.0	–11.8	–0.4	1.1
Number of negative companies	37	50	57	130	12	104
Number of positive companies	85	133	100	44	6	146

or 17.6%). Testing showed that the reporting difference between the two groups was statistically significant (i.e., chi-square test statistic of 5.161 producing a p-level of .023).

It appears the choice of reporting format under ASU 2011-05 demonstrates more independence than existed under SFAS 130. More specifically, prior research indicates that numerous factors affected (or were at least related to) reporting preference under SFAS 130, whereas current research suggests that a relationship exists between reporting choice and only one trait (i.e., operating performance or profitability). More profitable companies seem less likely to present comprehensive income in a continuous statement format than less profitable ones. This finding possesses intuitive appeal, because managers of companies with strong operating performance would likely prefer that net income not appear in a statement with items of OCI and comprehensive income, but rather be presented in its own, stand-alone statement. Although this finding is logical, it unfortunately suggests that a somewhat biased reporting decision relative to comprehensive income still exists.

Items of OCI. The final analysis involves descriptive statistics for the four major items of OCI presented in the statement of comprehensive income. *Exhibit 4* shows summary information for each of these individual OCI items as well as total OCI. Gains or losses from foreign currency translation adjustments represented the most common OCI item, occurring for 183 (73.2%) of the 250 entities. The least common OCI item was unrealized holding gains or losses on available-for-sale securities, which occurred for 122 (48.8%) companies. The most significant OCI item in terms of dollar amount was pension-related adjustments, with a median amount of −$11.8 million for the 174 companies presenting this item. For pensions, the number of companies reporting a negative OCI amount (130) greatly exceeded the number of companies with a positive amount (44). The opposite situation existed for the other three OCI items; only 18 (7.2%) of the companies reported a category for "other" OCI items.

When considering total OCI, *Exhibit 4* reveals the median amount for all companies was $1.1 million, with the majority (146, or 58.4%) reporting positive total OCI. Without considering the sign of total OCI (i.e., using absolute values), the magnitude of the median total OCI becomes much more impressive ($21.1 million). Concerning the tax effects, 226 (90.4%) of the 250 companies presented the individual OCI items on a net of tax basis. These entities were almost evenly split between those that reported the tax amount parenthetically in the OCI line item versus those that provided no tax amount (i.e., merely stated "net of tax" but without the tax effect reported in the statement). Only 24 (9.6%) of the companies presented the OCI items on a before-tax basis with a separate line item for total tax expense/benefit at the bottom of the statement just before the determination of comprehensive income.

More profitable entities exhibited a lower tendency to report comprehensive income in a continuous income statement.

Additional Considerations

Even though FASB allowed OCI items and comprehensive income to be reported in a non-performance-based statement under SFAS 130, the board held firm in its belief that these items do impact financial performance and should be reported as such. Of a sample of *Fortune* 1000 companies adopting ASU 2011-05 for the first time (i.e., 2012), the overwhelming majority (218 of 250, or 87.2%) reported comprehensive income in a separate statement. For the remaining companies (32, or 12.8%) that presented comprehensive income in a continuous income statement along with net income, the location where the companies presented EPS information was not consistent. About half placed EPS information immediately after net income, providing a separation between net income and the computation of comprehensive income; the other half placed EPS information at the very bottom, just below comprehensive income. It is unlikely this reporting inconsistency created any real impediment to the use of the financial statements; however, guidance by FASB on the placement of EPS information within the continuous statement format would, in the authors' opinion, eliminate any doubt in future years.

Finally, the results suggest that operating performance or profitability affects the reporting preference for comprehensive income to a noticeable degree. More profitable entities exhibited a lower tendency than less profitable ones to report comprehensive income in a continuous income statement. Perhaps managers of more profitable companies did not want users confusing comprehensive income with net income, and the separate statement format would seem to lessen the likelihood that such confusion would occur. ❑

Charles E. Jordan, DBA, CPA, *is an adjunct professor of accounting at Florida State University–Panama City.* ***Stanley J. Clark, PhD, CPA,*** *is an associate professor of accounting at Middle Tennessee State University, Murfreesboro, Tenn.*