A Comprehensive Approach to Comprehensive Income

THREE ACCOUNTING STANDARDS UPDATES (ASUs) PROVIDE NEW OPTIONS FOR REPORTING COMPREHENSIVE INCOME, AND THEY AREN'T AS COMPLEX AS THEY SEEM.

By Jo Lynne Koehn and Sandra Waller Shelton

The Financial Accounting Standards Board (FASB) has had a lot to say in the last few years with respect to comprehensive income. Since June 2011, it has issued three separate Accounting Standards Updates (ASUs) that, taken together, reflect the Board's initial direction as well as its responses to the challenges and concerns of those entities that would be impacted.

Now that things have shaken out, let's examine how each of the updates affects how organizations—very likely including yours—will analyze and report comprehensive income.

What the New ASUs Require

ASU No. 2011-05. *Comprehensive Income (Topic 220): Presentation of Comprehensive Income* (June 2011)

Prior to ASU 2011-05, U.S. Generally Accepted Accounting Principles (GAAP) allowed three ways to present comprehensive income along with its respective components: (1) a second income statement, (2) a combined statement of comprehensive income, or (3) as a part of the statement of stockholders' equity. Most entities chose this third option, but the new update has eliminated it.

What are the current choices? An entity can opt to present the total of comprehensive income, the components of net income, and the components of other comprehensive income (OCI) in a single continuous statement or in two separate, *but consecutive*, statements.

Using the single-statement approach, in addition to a total for comprehensive income, the organization must present the components of net income and total net income, the components of OCI, and a total for OCI. The two-statement approach, on the other hand, requires entities to present components of net income and total net income in the net income statement. The consecutive statement of OCI should immediately follow the net income statement and include all of the components previously mentioned in the single statement. These financial reporting requirements apply to both interim and annual statements.

The update didn't change the requirements for:

1. The nature of items that must be reported as other comprehensive income.
2. The timing of when an item must be reported as being reclassified from OCI to an item affecting net income.
3. The option for entities to report OCI items as either net of the related tax effect or before the tax effect—with one item showing the aggregate related tax expense (or benefit). Companies have the option of disclosing the tax effects for each component of comprehensive income (including reclassification adjustments) in the notes or in the comprehensive income statement.
4. The calculation or presentation of earnings per share.

For public entities, the effective date for compliance with ASU 2011-05 was for fiscal years, and interim periods within those years, beginning after December 15, 2011. For nonpublic entities, the guidance was effective for fiscal years ending after December 15, 2012.

ASU No. 2011-12. *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting* (December 2011)

The initial update (2011-05) added another requirement with respect to items being reclassified in the current year from accumulated OCI to net income. The update proposed that organizations be required to report the effects of reclassification adjustments out of accumulated OCI in the financial statements in which components of net income or OCI are presented. The adjustments were to be shown alongside parenthetically or below the affected component on the financial statement. For example, a "gain on sale of securities" on the income statement could be followed by a "gain on securities reclassified from accumulated OCI (AOCI)."

Not surprisingly, numerous concerns were raised relative to reclassifications, including:

- Additional electronic data processing (EDP) system costs needed to track line-item effects.
- The greater complexity related to the increase in the number of line items needed on financial statements to comply with this requirement.
- The added difficulty of tracking adjustments that might first be capitalized and then later amortized to the income statement.
- The effects on interim reporting, given that interim reporting allows condensed formats for statements.
- Comparability to International Financial Reporting Standards (IFRS), given that fewer items are required as reclassifications from accumulated OCI to net income under IFRS.

To allow further study of these issues, the FASB deferred the line-item component reclassification requirement of ASU 2011-05. Therefore, the guidance of ASU 2011-12 allowed companies to continue to present reclassification adjustments as they had before 2011-05, either (a) on the face of the financial statement, where comprehensive income is reported, or (b) in the notes to the financial statements. This deferral, however, removes the requirement to report the effects of the adjustments on the *components* of net income.

ASU No. 2013-02. *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* (February 2013)

These recent amendments to Topic 220 don't change the current requirements for reporting net income or OCI. The difference now is that organizations need to provide information about adjustment amounts out of accumulated OCI by component. If a particular amount being reclassified is required under GAAP to be reclassified *in its entirety* to net income, then it must be reported on the respective line item. By contrast, amounts that aren't entirely reclassified under GAAP to net income in the same reporting period must be cross-referenced to other disclosures about those amounts. An example would be where a portion of an item being reclassified out of accumulated income is first capitalized to a balance sheet account (perhaps inventory or a fixed asset), then later amortized to income or expenses in a subsequent reporting period.

The 2013-02 guidance is to be applied prospectively if your organization has annual reporting periods beginning after December 15, 2012, and interim periods within those annual periods. The effective date for nonpublic entities is a year later, beginning after December 15, 2013.

An Examination of Fundamental Analysis Issues

Let's now review fundamental analysis issues (specifically, income statement common-sizing and ratio analysis) relative to comprehensive income. To facilitate this, we'll rely on sample statements that the FASB provided in ASU 2011-05. Although ASU 2011-12 may alter how the reclassification adjustment portions of these statements will appear, the difference isn't germane to our discussion.

Option One: The Single Continuous Statement

Common-sizing the income statement by expressing all lines as a percentage of revenues is a common procedure that allows finance professionals to gauge the relative impact of each item when making intercompany comparisons. This technique is also useful when comparing results between years for the same entity. For clarity, the tables in this article show information for one year even though most entities are required to present comparative statements.

> The new prominence of OCI items and comprehensive income will provide new options for common-sizing the income statement.

Table 1 displays the first option permitted, which is a single continuous statement of comprehensive income. The top section is a traditional income statement with one notable exception: The update requires companies reclassifying items from "other comprehensive income" to explicitly show the reclassifications. Table 1 reveals two such reclassifications that involve amortization of prior pension service cost and security gains.

The first option extends the income statement (after double-ruling net income on the first section) to show the detail of all OCI items. The extension culminates with the calculation of comprehensive income. The OCI section also details the items being reclassified to the income statement, which are reported net of tax in the lower portion of the continuous statement but at their gross amounts once they've been reclassified and included in net income. For example, the OCI section reports the amortization of prior service cost included in net periodic pension cost at $100, reduced from the gross amount of $133.

You do, however, have the option of showing the OCI items in the lower portion of the continuous statement net of tax or at gross amounts. With the latter approach, income tax expense appears on a separate line as illustrated in Table 1A.

Table 1 displays the common-sizing approach that finance professionals typically use when scrutinizing an income statement. Usually this technique re-expresses all

Table 1: Single Continuous Statement Approach

This column shows the common-sizing technique that accountants historically have used when evaluating the income statement. All dollars are expressed as a % of revenues.

XYZ COMPANY
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 201X

			Common-Sized %
Revenues		$140,000	100.00%
Expenses	-$24,900		-17.78%
Amortization of prior service cost reclassified from other comprehensive income	-133	-25,033	-0.10%
Other gains and losses		8,000	5.71%
Gain on sale of securities	500		0.36%
Gains reclassified from comprehensive income	2,000	2,500	1.43%
Income from operations before tax		125,467	89.62%
Income tax expense		-31,367	-22.41%
Income before extraordinary item		94,100	67.21%
Extraordinary item, net of tax		-30,500	-21.79%
Net income		63,600	45.42%
Less: Net income attributable to noncontrolling interest		-12,720	-9.09%
Net income attributable to XYZ Company		$50,880	36.33%
Earnings per share–basic and diluted		$0.46	
Other comprehensive income, net of tax:			
Foreign currency translation adjustments		$8,000	?
Unrealized gains on securities:			
Unrealized holding gains arising during period	$13,000		?
Less: Reclassification adjustments for gains included in income	-1,500	11,500	
Defined benefit pension plans:			
Prior service cost arising during the period	-1,600		
Net loss arising during the period	-1,000		
Less: Amortization of prior service cost included in net periodic pension cost	100	-2,500	?
Other comprehensive income		17,000	?
Comprehensive income		80,600	?
Less: Comprehensive income attributable to noncontrolling interest		-16,120	?
Comprehensive income attributable to XYZ Company		$64,480	?

ASU 2011-05 requires that the income statement show any amounts reclassified from other comprehensive income.

For the extended section of the continuous statement option, the appropriate base for common-sizing isn't clear.

Composed of:

Net Income	$12,720
Other Comp. Inc. items	3,400
Total	$16,120

Composed of:

Net Income	$50,880
Other Comp. Inc. items	13,600
Total	$64,480

Table 1A: Alternative Tax Treatment for Bottom Section of Single Continuous Statement

Other comprehensive income		
Foreign currency translation adjustments		$10,666
Unrealized gains on securities:		
Unrealized holding gains arising during period	$17,333	
Less: Reclassification adjustments for gains included in income	-2,000	15,333
Defined benefit pension plans:		
Prior service cost arising during the period	-2,133	
Net loss arising during the period	-1,333	
Less: Amortization of prior service cost incl. in net periodic pension cost	133	-3,333
Other comprehensive income, before tax		22,666
Income tax expense related to other comprehensive income		-5,666
Other comprehensive income, net of tax		17,000
Comprehensive income		80,600
Less: Comprehensive income attributable to noncontrolling interest		-16,120
Comprehensive income attributable to XYZ Company		$64,480

ASU 2011-05 allows for other comprehensive income to be shown net of tax (see Table 1) or as shown here with a collective income tax expense for all of the comprehensive income items.

dollar amounts as a percentage of revenues, as shown in the final column of the table. With the new, proposed single continuous statement, common-sizing works well for the top half of the statement through the net income number.

It's less clear how to extend common-sizing to the lower section. Each OCI item can continue to be expressed as a percentage of revenues, but this approach may not allow the percentages to be subtracted to the bottom line, as is usually true for a common-sized income statement. Also, it can become confusing as to which percentages to sum together to prove the accuracy of the percentage allocations.

Table 2 shows the choice of common-sizing the continuous income statement by expressing dollars in the lower section to match the upper portion—that is, also as a percentage of revenues. This extension of traditional common-sizing provides information on the materiality of the OCI items and shows that the percentage of comprehensive income attributable to the entity (46.06%) is greater than its net income (36.33%). This wouldn't necessarily be the case if large other comprehensive loss items were present.

Option 2: A New Way to Common-Size

The new income statement guidance allows income to be reported using two consecutive statements. With the second statement, you can use net income from the first statement as the first line. In Table 3, this is shown as $63,600, carried down from the first income statement. The second statement then provides the details of the OCI items, culminating in the comprehensive income attributable to the reporting entity.

While some people may feel that allowing a second statement of income is less transparent than the single-statement option, when it comes to common-sizing, the second statement presents an appealing approach that isn't available with the single-statement format. Since net income is the starting point for the second statement, its presence allows the component percentages to be displayed clearly. In Table 3, for example, with the second-statement dollar amounts expressed as a percentage of comprehensive income, it's easy to see the proportion that net income represents (78.91%) as well as the contributions of the OCI items to total income (21.09%).

Table 2: Single Continuous Statement Fully Common-Sized

XYZ COMPANY
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 201X

			Common-Sized %
Revenues		$140,000	100.00%
Expenses	-$24,900		-17.78%
Amortization of prior service cost reclassified from other comprehensive income	-133	-25,033	-0.10%
Other gains and losses		8,000	5.71%
Gain on sale of securities	500		0.36%
Gains reclassified from comprehensive income	2,000	2,500	1.43%
Income from operations before tax		125,467	89.62%
Income tax expense		-31,367	-22.41%
Income before extraordinary item		94,100	67.21%
Extraordinary item, net of tax		-30,500	-21.79%
Net income		63,600	45.42%
Less: Net income attributable to noncontrolling interest		-12,720	-9.09%
Net income attributable to XYZ Company		$50,880	36.33%
Earnings per share–basic and diluted		$0.46	
Other comprehensive income, net of tax:			
Foreign currency translation adjustments		$8,000	5.71%
Unrealized gains on securities:			
Unrealized holding gains arising during period	$13,000		
Less: Reclassification adjustments for gains included in income	-1,500	11,500	8.21%
Defined benefit pension plans:			
Prior service cost arising during the period	-1,600		
Net loss arising during the period	-1,000		
Less: Amortization of prior service cost included in net periodic pension cost	100	-2,500	-1.77%
Other comprehensive income		17,000	12.15%
Comprehensive income		80,600	57.57%
Less: Comprehensive income attributable to noncontrolling interest		-16,120	-11.51%
Comprehensive income attributable to XYZ Company		$64,480	46.06%

On this lower section, the dollar amounts are also expressed as a percentage of revenues.

Table 3: Two Consecutive Statements Approach

XYZ COMPANY
CONSOLIDATED STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 201X

			Common-Sized %
Revenues		$140,000	100.00%
Expenses	-$24,900		-17.78%
Amortization of prior service cost reclassified from other comprehensive income	-133	-25,033	-0.10%
Other gains and losses		8,000	5.71%
Gain on sale of securities	500		0.36%
Gains reclassified from comprehensive income	2,000	2,500	1.43%
Income from operations before tax		125,467	89.62%
Income tax expense		-31,367	-22.41%
Income before extraordinary item		94,100	67.21%
Extraordinary item, net of tax		-30,500	-21.79%
Net income		63,600	45.42%
Less: Net income attributable to noncontrolling interest		-12,720	-9.09%
Net income attributable to XYZ Company		$50,880	36.33%
Earnings per share–basic and diluted		$0.46	

XYZ COMPANY
STATEMENT OF CONSOLIDATED COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 201X

The second statement shows all dollars common-sized with comprehensive income (rather than revenues) as the base.

Net income		$63,600	78.91%	
Other comprehensive income, net of tax:				
Foreign currency translation adjustments		$8,000	9.92%	
Unrealized gains on securities:				
Unrealized holding gains arising during period	$13,000		14.27%	
Less: Reclassification adjustments for gains included in income	-1,500	11,500		
Defined benefit pension plans:				
Prior service cost arising during the period	-1,600			
Net loss arising during the period	-1,000			
Less: Amortization of prior service cost incl. in net periodic pension cost	100	-2,500	-3.10%	
Other comprehensive income		17,000	21.09%	
Comprehensive income		80,600	100.00%	125.00%
Less: Comprehensive income attributable to noncontrolling interest		-16,120	-20.00%	-25.00%
Comprehensive income attributable to XYZ Company		$64,480	80.00%	100.00%

Accountants may want to display two compositions at the bottom of the second statement. The first composition shows that XYZ Company's percentage of comprehensive income is 80%. The last column shows that if comprehensive income attributable to XYZ Company serves as the common-sizing base, then total comprehensive income is 25% more than the firm's share.

Reporting Stockholders' Equity

Under the new guidance, the statement of changes in stockholders' equity will still contain a column for AOCI, but without any further detail. This detail will now reside on the bottom of the consolidated statement of comprehensive income or, with the second-statement option, on the statement of consolidated comprehensive income. (The names of the statements are very similar but are specific to each particular option.) Under the new standards update, only the total for the OCI items will appear under the AOCI column on the statement of changes in equity. Adding the total of OCI items to the beginning AOCI balance for the period allows the beginning and ending balances for AOCI to be reconciled. In Table 1, for example, XYZ Company reported a total of OCI items of $13,600, which is displayed in Table 4.

Users may more easily consider the concept of "structure of income" and an expanded set of profitability metrics.

Income Structure

Finance professionals speak of the "capital structure" of the balance sheet in dissecting the means of financing the assets. For example, a company might carry a capital structure of 45/55, meaning that debt finances 45% of the assets and equity the remaining 55%.

With the OCI items moving from the statement of changes in stockholders' equity to a more prominent display on the consolidated statement of comprehensive income, accountants will have a way to structure income by assigning percentages, much like they do when parsing debt and equity on the balance sheet. They may tier the income structure between net income and OCI to add to the 100% composition of income. Structuring income in this way highlights the impact that the OCI items have on the firm's comprehensive income.

Creating a commonly accepted structure of income makes it easier to compare entities. Finance professionals may also gain insights into those portions of comprehensive income that management is less able to control and be better able to sift out OCI not related to core operations. The structuring of income using the income from Table 1, which is reported in Table 5, is 78.9% and 21.1%.

Table 4: Selected Column from the Statement of Changes in Stockholders' Equity

	ACCUMULATED OTHER COMPREHENSIVE INCOME
Beginning Balance	$18,400
Other Comprehensive Income	13,600
Ending Balance	$32,000

Expansion of Profitability Ratio Set

Finance professionals typically group ratios into categories according to what the ratios measure. Generally accepted categories include liquidity, solvency, efficiency, and profitability. In the profitability category, accountants traditionally compute gross margin, operating margin,

Table 5: Structuring of Income

	CONSOLIDATED STRUCTURE OF INCOME		XYZ COMPANY'S STRUCTURE OF INCOME	
Net Income	$63,600	78.9%	$50,880	78.9%
Other Comprehensive Income	17,000	21.1%	13,600	21.1%
Comprehensive Income	$80,600	100.0%	$64,480	100.0%

Table 6: Expansion of the Set of Profitability Ratios for XYZ Company

TRADITIONAL PROFITABILITY RATIOS		PROPOSED RATIOS	
Operating Income Ratio	$125,465/$140,000 = 89.6%	Other Comprehensive Income Ratio	
		(Calculated as: OCI Items/ Comprehensive Income)	$13,600/$64,480 = 21.1%
		Net Income Ratio	
		(Calculated as Net Income/ Comprehensive Income)	$50,880/$64,480 = 78.9%
Profit Margin Ratio	$50,880/$140,000 = 36.3%	Comprehensive Income/ Net Income Ratio ("Comp to Net")	$64,480/$50,880 = 126.7%

net margin, free cash flow margin, return on assets, and return on equity. In Table 6 you'll see that the operating margin for XYZ Company is 89.6%, and the net margin is 36.3%.

As OCI and comprehensive income move closer in the financial statements to an entity's other calculations of profit, it's likely that finance professionals will consider expanding the set of computed profitability ratios. Now they can easily include relative comparisons of OCI items and comprehensive income since the amounts will reside on the same financial statement as gross profit, operating profit, and net income.

At a minimum, you'll probably want to measure the relative contribution of net income and OCI items to total comprehensive income. In the more traditional ratio format found in Table 6, these relationships are labeled "other comprehensive income ratio" (21.1%) and "net income ratio" (78.9%). Comprehensive income expressed as a multiple or percentage of net income will also allow users to make comparisons over multiple periods for the same entity. Using XYZ Company as our example, the multiple of comprehensive income to net income is 1.27, alternatively expressed as 126.7%. For easy reference, this ratio could be named "comp to net."

New Options for Reporting

While the new reporting requirements make it easier to compare entities reporting under U.S. GAAP to those preparing financial statements using IFRS, several differences will persist with respect to the nature of items reported as other comprehensive income as well as certain disparities regarding reclassification rules. The new prominence of OCI items and comprehensive income will provide new options for common-sizing the income statement. Additionally, users may more easily consider the concept of "structure of income" and an expanded set of profitability metrics, as presented in this article, featuring components of OCI and comprehensive income on a single statement or consecutive statements. As the future unfolds, it will be interesting to see which options from the new comprehensive income reporting requirements management accountants and other finance professionals decide to place in their toolkits. **SF**

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