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October 31, 2012

Ms. Leslie Seidman Chairman Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06865-5116

Re: Comment Letter on FASB Proposal to Change Presentation of Reclassification Adjustments

Dear Ms. Seidman,

CFA Institute, ¹ in consultation with its Corporate Disclosure Policy Council ("CDPC")², appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB") Proposed Accounting Standards Update, Comprehensive Income (Topic 220), Presentation of Items Reclassified Out of Accumulated Other Comprehensive Income ("Proposed Update"). The Proposed Update is an update to ASU 2011-12, Deferral of Effective Date for Amendments to the Presentation of Reclassification of Items out of Accumulated Other Comprehensive Income in ASU 2011-05.

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 115,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 139 countries, of whom nearly 109,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 137 member societies in 59 countries and territories.

The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.



OVERARCHING GENERAL OBSERVATIONS

We thank the FASB for the opportunity to comment on the Proposed Update. In these general observations, we highlight the following key messages:

- The issue being addressed by the Proposed Update is not a new issue. We believe the inability to satisfy the requirements of ASU 2011-05, *Presentation of Comprehensive Income*, is an acknowledgement of the fact that there is a lack of transparency regarding items recycled from other comprehensive income to net income. CFA Institute has long highlighted this lack of transparency to standard setters. The inability to satisfy this requirement has highlighted the problem that items reclassified out of other comprehensive income ("OCI") are not necessarily reclassified into net income.
- We reiterate our concerns regarding the sometimes arbitrary use of OCI and accumulated other comprehensive income ("AOCI") and reclassification of items from OCI and AOCI to Net Income ("NI").
- The Proposed Update backtracks from the requirements of ASU 2011-05 with its focus on disclosure rather than presentation and its failure to provide transparency regarding the fact that items reclassified out of OCI/AOCI are not necessarily reclassified into net income.
- We emphasize that the priority of the FASB should be the conceptual definition of OCI.

The Issue Being Addressed by the Proposed Update Is Not a New Issue

We disagree with the Proposed Update's suggestion that the limited transparency around items that are reclassified from OCI is a new issue. We raised this issue in our 2010 and 2011 comment letters³. Thus, the Proposed Update is an acknowledgment of the validity of our previously stated concerns regarding the lack of transparency around items recorded through OCI. Items reclassified out of OCI that are not directly reclassified into net income are a particular problem.

The belated identification of this issue raises the question of whether accounting standard setters fully appreciate the lack of transparency of OCI items from an investors' standpoint. Further, it pinpoints the need for the FASB and the International Accounting Standards Board ("IASB") (collectively, the Boards) to prioritize the development of a sound conceptual basis for OCI rather than extending and embedding its current arbitrary application.

We Reiterate Our Concerns Regarding Use of OCI and Recycling

As we have articulated in previous comment letters, we do not support the use of OCI because it has not been conceptually defined and we believe it is only a politically expedient solution for removing volatile measurements from net income. While investors may have varying views about whether some volatile measurements should be excluded from net income, we believe that obscuring such adjustments does not promote efficiency in the capital markets.

³ CFA Institute comment letters include:

a) September 30, 2010 comment letter to IASB and FASB on Presentation of Items of Other Comprehensive Income.

b) November 30, 2011 comment letter to FASB on Deferral of Effective Date for Amendments to the Presentation of Reclassification of Items out of Accumulated Other Comprehensive Income in ASU 2011-05.



Similarly, we have concerns regarding recycling amounts from OCI to NI due to the following reasons:

- No Conceptual Basis Similar to the OCI concept, recycling has no conceptual basis.
- Difficult for Investors to Determine When to Accord Meaning It is difficult for investors to assign economic meaning to gains or losses that occur during one period and are included in equity but are only recognized in net income, with little transparency, in one or more subsequent periods.
- Can Be Done at Management Discretion Recycling may be done at management's discretion (e.g. when available-for-sale securities are sold).
- Insufficient Transparency on Recycled Items There has been little or no transparency on when, where, why and by how much the items reclassified out of OCI affect net income.

Our concern regarding the lack of transparency due to classification of items in OCI/AOCI and reclassification of items from OCI/AOCI along with when they affect net income is supported by member feedback⁴.

The Proposed Update Does Not Go Far Enough to Improve Transparency on Reclassified OCI Items

As noted, we have previously expressed our concerns regarding the limited transparency of OCI. Investors need significant improvement in transparency around items classified into and reclassified out of OCI/AOCI. The need for greater OCI transparency is backed not only by CFA Institute survey results but also by a recent PwC Survey⁵, which found that 57% of respondents did not consider OCI to be clear enough. We were strongly supportive of the proposed requirements made in the 2010 FASB ED and included in ASU 2011-05 as these would have required separate presentation of reclassified OCI adjustments within each line of net income (i.e. both their location and the amount of the reclassification). The Proposed Update backtracks from the ASU 2011-05 with its focus on disclosure rather than presentation and its failure to provide transparency regarding the fact that items reclassified out of OCI/AOCI are not necessarily reclassified into net income.

Crucially, as we discuss further below, the proposal fails to sufficiently enhance transparency regarding the most opaque reclassification adjustments – such as the adjustments being reclassified out of OCI to the balance sheet and then NI (e.g. post-retirement benefits costs). By creating partial reclassification as a new term and adding the cross-referencing requirements for the aforementioned opaque adjustments, the FASB seems to be acknowledging that the amount and timing of these adjustments' impact on net income is not known by reporting companies. If reporting companies can't explain the effects of recycled items on the financial statements, how can investors hope to understand them; this issue alone questions the use of recycling as an accounting approach.

Priority of Board(s) Should be on Defining Purpose and Use of OCI

The importance of defining OCI was highlighted in the recent PwC survey⁶ as exemplified by the following comment by one of the investor respondents:

'General principles of what goes in OCI and what should be recycled should be defined within the conceptual framework.'

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⁴ A past CFA Institute member survey conducted on the 2009 IFRS 9 Financial Instruments, *Classification and Measurement*, Exposure Draft (IFRS 9 ED survey). The IFRS 9 ED survey found that 55% of respondents supported the then proposed prohibition on recycling. There is substantially less recycling under IFRS than under US GAAP.

⁵ PricewaterhouseCoopers (2012), Financial Reporting Priorities: A European Investor View.

⁶ Ibid.



Due to overall poor transparency around OCI the Boards should seek to define OCI and when and how it should be used. We reiterate our concern about the continued use of OCI as a primary means of avoiding net income volatility. We believe the primary focus should be on addressing the purpose of OCI as part of the development of the conceptual framework. We made similar comments to the IASB in their agenda consultation.

SPECIFIC COMMENTS ON PROPOSED UPDATE

The following is a summary of our key responses to the specific proposals within the Proposed Update:

- New tabular disclosure of amount reclassified out of OCI is a limited improvement.
- Newly introduced term of "partial reclassification" needs further conceptual justification.
- Cross-referencing to the notes for items partially reclassified does not increase the transparency of reclassified OCI adjustments.
- We support interim disclosures.
- We support consistent public and nonpublic requirements.
- We support the proposed effective date.

We elaborate on these responses below.

New Tabular Disclosure of Amount Reclassified Out of OCI (But Not Necessarily Into NI) is Only A Limited Improvement

Relative to the original requirement to present the reclassification adjustments on the face of the income statement – as had been proposed in ASU 2011-5 – the approach in the Proposed Update decreases the visibility of reclassification adjustments in the income statement. The proposed tabular disclosure will only be a limited improvement from current reporting practices. While it will provide a single location for items reclassified out of other comprehensive income, which is an improvement, it fails to highlight the effect of the reclassifications on the income statement and the tabular presentation fails to address the most important issue made more apparent in the attempt to implement ASU 2011-5.

The issue not addressed by the tabular disclosure is that certain reclassification adjustments (e.g. post-retirement benefits costs) are reclassified out of other comprehensive income but they are not recycled directly into net income in the same period. The disclosure fails to make this clear to investors. Further, the cross-referencing, discussed more extensively below, increases confusion for investors.

Further, the FASB should clarify and explicitly state whether the Proposed Update intended that "shadow adjustments" on unrealized gains/losses for insurers should not result in reclassification adjustments. In

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Shadow adjustments of insurers relate to deferred policyholder acquisition costs (DAC) and certain other policyholder account balances. The adoption of SFAS 115 necessitated the creation of shadow adjustments. The objective of shadow adjustments was to ensure the faithful representational of economic reality of stockholder's book equity. When SFAS 115 was being implemented in 1994, actuaries observed that any adjustment to reflect marketable securities at fair value through equity would require an adjustment to accounts such as DAC to properly reflect the net economic impact of these unrealized gains/losses to the stockholder's equity of the enterprise. If shadow adjustments to accounts such as DAC were not recorded, then when such unrealized gains/losses were realized through net income there would have been an impact to the amortization of DAC in net income which would result in total comprehensive income and stockholder's equity changing because of management's decision to sell the security. This was not considered reflective of the economic value to the enterprise of the security and its associated unrealized gain/loss. When the unrealized gains/losses become realized gains/losses they are by definition "reclassification adjustments." In an identical manner, the shadow adjustment made to balance sheet accounts such as DAC also come out of OCI and are "shadow adjustment reclassifications." Without them equity would not be the same upon recognition of the gain/loss. The wording the Proposed Update suggests this entry does not occur which is counter to the genesis of the basis for the need for shadow adjustments which was identified upon adoption of SFAS 115 in 1994.



other words, whether the Proposed Update has gone beyond ascertaining the disclosure and presentation of reclassification adjustments and in effect is also determining what is or is not a reclassification adjustment. If that be the case, our view is that the Proposed Update – in the context of shadow adjustments for insurers – has gone beyond its original mandate. Under separate cover, we have provided an analysis and example of this issue to the FASB Staff.

While we agree with the tabular presentation we believe the inability of preparers to identify when, where and by how much these items are recycled into net income should be made more obvious to investors and other financial statement users. We recommend that, at a minimum, a cross-reference should also be added to the income statement, so that there is full transparency across both source and destination of items reclassified out of OCI to net income. In this way investors are enabled to consider reclassification items for particular financial statement captions.

Newly Introduced Term - "Partial Reclassification" - Needs Conceptual Justification

For amounts that are not fully reclassified out of OCI to net income, the Proposed Update has introduced a new term of "partial reclassification". Partial reclassification occurs when the full amount of the amount reclassified out of OCI recorded into another the balance sheet account and then reclassified into net income at a later date – possibly over time. However, our understanding is that amounts reclassified from OCI onto the balance sheet could also be reclassified in full to net income – in the same time period or in a different period – from when it was reclassified out of other comprehensive income. In other words, OCI reclassified adjustments to balance sheet are not necessarily recognized "partially to net income" when subsequently reclassified.

Because of this and because US GAAP does not currently define "partial recognition" we do not support this new terminology. Investors are likely to be confused by this undefined new term.

The Proposed Update proposes that, within the tabular disclosures, there should be cross-referencing to the respective notes to the account of amounts that are "partially reclassified". In the sections below, we discuss how this approach retains the current opaqueness related to OCI reclassification adjustments, which are first reclassified within the balance sheet and then to net income.

Cross Referencing to Notes for Items Partially Reclassified Does Not Increase the Transparency of Reclassified OCI Adjustments

For items that are partially reclassified, the proposal would allow cross-referencing to other note disclosures where the accounting for the item is discussed (most significantly pensions). The problem is that there is likely to be nothing in the note being cross-referenced which explains the amount, timing or location of the reclassification.

To assess the effectiveness of the requirements of the Proposed Update, generally, and to assess whether the cross-referencing approach could be useful, we reviewed IBM's 2011 Annual Report and constructed the disclosures required by the Proposed Update. Specifically we constructed the table on Page 12 of the Proposed Update for IBM for the year ended December 31, 2011. We chose IBM as it provided unsolicited comments to the FASB seeking to amend the requirements in ASU 2011-5. The results of our work are included in **Appendix A**.

We found reclassification adjustments related to cash flow hedging and realized gains/losses readily identifiable. However, the adjustments related to pension/post-retirement reclassifications which are likely to be considered partially reclassified are likely to be difficult for investors to trace and without clarity as to when, where and by how much these amounts are recycled into net income.



We believe that most companies be unable to provide investors with the net income effects of OCI reclassification adjustments made initially to the balance sheet and then to net income. Moreover, investors are unlikely to be aware of any such reclassification due to the opaque reporting. The FASB seems to have acknowledged the problem of opacity of OCI reclassifications into the balance sheet, as it has asked staff members to conduct an analysis of current issues in the guidance of accounting for postretirement benefits and to develop a recommendation as to whether the FASB should undertake a future project to improve financial reporting in this area.

We urge the FASB to explicitly acknowledge managements' inability to determine the amount and timing of income statement effects related to OCI reclassification adjustments made within the balance sheet and then to net income. The FASB should require financial statements to disclose, where applicable, that management is unable to describe and quantify the amount or timing of the reclassification into net income.

Interim Disclosures

We support equivalent interim and annual disclosures as investors evaluate earnings quarterly not annually.

We Support Consistent Public and Nonpublic Requirements

We support consistent requirements for both public and nonpublic entities. We believe, as we have stated in other comment letters, that the line between public and nonpublic companies is increasingly less meaningful and that all shareholders require the same information regardless of technical distinctions based on the securities laws.

We Support The Proposed Effective Date

We support immediate adoption of changes through the proposed effective dates, namely:

- Effective for public entities for annual reporting periods ending after December 15, 2012.
- Effective for nonpublic entities for annual reporting periods ending after December 15, 2013.

CLOSING REMARKS

If you, other board members or your staff have questions or seek further elaboration of our views, please contact either Vincent T. Papa, PhD, CFA, by phone at +44.207.531.0763, or by e-mail at vincent.papa@cfainstitute.org, or Sandra J. Peters, CPA, CFA, by phone at +1.212.754.8350, or by e-mail at sandra.peters@cfainstitute.org.

Sincerely,

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Head, Financial Reporting Policy
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/s/ Gerald I. White Gerald I. White, CFA Chair Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council