

30<sup>th</sup> September 2010

Sir David Tweedie  
Chair, International Accounting Standard Board  
International Accounting Standard Board  
30 Cannon Street  
EC4M 6XH  
United Kingdom

Ms. Leslie Seidman  
Chair, Financial Accounting Standard Board  
Financial Accounting Standard Board  
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P.O Box 5116  
Norwalk, CT 06865-5116  
USA

**Re: Comment Letter on Presentation of Items of Other Comprehensive Income**

Dear Sir David and Ms. Seidman,

The CFA Institute,<sup>1</sup> in consultation with its Corporate Disclosure Policy Council (“CDPC”)<sup>2</sup>, appreciates the opportunity to comment on the following proposed accounting standards: International Accounting Standards Board’s (“IASB”) Exposure Draft (“IASB Exposure Draft” or “IASB ED” ), *Presentation of Items of Other Comprehensive Income* and Financial Accounting Standards Board’s (“FASB”) Proposed Accounting Standards Update, *Comprehensive Income (Topic 220), Statement of Comprehensive Income* (“FASB Proposed Update” or “FASB Update”). The IASB Exposure Draft and the FASB Proposed Update are referred to collectively as the Proposed Standards. The IASB and FASB are collectively referred to as the Boards.

CFA Institute represents the views of its 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

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<sup>1</sup> With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 96,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 133 countries, of whom nearly 83,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

<sup>2</sup> 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.

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those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

## GENERAL COMMENTS

### *Decision-Usefulness of Other Comprehensive Income*

Other comprehensive income (“OCI”) is an accounting construct, created by standard setters to deal with controversial areas. It is used to defer income statement recognition of valuation changes that would add volatility to reported net income. The line between net income and OCI is, in our view, arbitrary and does not reflect any underlying economic difference. For that reason we support any effort to make it more difficult for preparers to “hide” or otherwise deemphasize OCI.

There is a substantial body of empirical evidence supporting our view that OCI information (e.g. foreign currency translation adjustments, cash flow hedges and pension related expenses) is relevant<sup>3</sup> for investors. Further, there is evidence of analytical adjustments made by investors using OCI information. For example, Moody’s credit rating agency noted<sup>4</sup> that it adjusts equity for some OCI items to better reflect, for analytical purposes, the underlying economics of transactions and events and to identify and segregate the effects of unusual or non-recurring items. Due to the materially significant transactions accounted for through the OCI as shown in Appendix 1 and the decision-useful nature of such information, more needs to be done to ensure OCI information has higher levels of visibility to investors and that there is a consistent understanding of the attributes of information reflected through OCI.

The Proposed Standards require a continuous presentation of the comprehensive income statement, with a distinction made between the profit and loss/net income and other items of comprehensive income. We strongly support this proposed change because the location of information in financial statements has implications for prominence accorded by investors. The more prominence accorded in presentation, the more likely it will be that such information is broadly applied by investors in their analytical processes. A centralised location simply makes it easier for readers to pay attention to any related information set. We concur that this change will improve comparability, consistency and transparency in financial reporting.

### *Conceptual Framework for Other Comprehensive Income*

**The definition of a conceptual framework is urgently required to determine the basis of use of the OCI.** As noted within the ED, the OCI statement has no conceptual basis, and can be considered as an artefact of compromise-based standard setting, as it has often been used as a repository for items that conceptually belong in the income statement. OCI items include fair value changes associated with gains and losses on cash flow hedges, foreign currency translation effects and postretirement benefit adjustments.

<sup>3</sup> A) Pinto (2005), ‘How Comprehensive is comprehensive income? -The value -relevance of foreign currency translation adjustments’, Journal of International Financial Management & Accounting, 16, 97-122. This study provides empirical research showing that retrospective data analysis of foreign currency translation adjustments can be a lead indicator of EPS in future periods.

B) Chambers, Linsmeier, Shakespeare, and Sougiannis, 2007, ‘An evaluation of SFAS 130 Comprehensive Income Disclosures’, Review of Accounting Studies, Pages 557-593

<sup>4</sup> Moody’s, April 2006, ‘Moody’s Approach to Other Comprehensive Income Items When Calculating Effective Leverage for Finance Companies’ -Rating Methodology- Authors- Emrick.C, Wasden.M and Young.R

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**We emphasize that OCI, as a whole, remains difficult for investors to understand due to the lack of a conceptual framework.** The presentation of OCI as currently constructed, contributes to a disconnect between the inherent volatility associated with a business and the volatility of its earnings. In effect earnings are being adjusted to artificially appear less volatile than they truly are. In addition, both Boards continue to add information to the OCI through the financial instruments projects and the IASB is further doing so through the post employment benefits project. The interpretation difficulties are compounded by having some items being recycled and others not, as currently required by the IASB.

The absence of a conceptual framework also contributes to:

- The opportunistic application of the OCI statement for areas that are difficult to resolve continues to occur. This compounds the difficulties that investors face whilst interpreting information that has been recognised through OCI;
- Unwarranted pushback towards the improvement of standards. For example, an innocuous and beneficial change such as having all related comprehensive income information in one page seems to have encountered opposition with the lack of a conceptual framework being cited as a reason;
- The emergence of inaccurate alternative postulations<sup>5</sup> regarding the purpose of OCI, as reflected in some stakeholder comments, so as to fill the vacuum in understanding of its purpose.

There are a number of questions in relation to OCI that a conceptual framework will need to address, including:

- What is the purpose of OCI?
- What should be included in OCI?
- Should OCI be eliminated entirely?
- Should OCI be retained but recycling prohibited?
- Should OCI treatment be confined to resolution on a standard by standard basis? However, the downside of dealing with OCI on an ad-hoc, project-by-project basis is that it will likely entrench its incoherent and conceptually unjustified application.

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<sup>5</sup> ABA's Comment Letter<sup>5</sup> to the FASB on the Proposed Update (ABA Comment Letter (1 of 3) to FASB on Proposed Update; Comment Letter #229; Donna J. Fisher; ABA; August 31, 2010; pg. 9.) highlights the misunderstanding of comprehensive income:

*'Fair value accounting changes the concept of "comprehensive income" within FASB's Conceptual Framework. ....Within the Accounting Standards Codification, "comprehensive income" and "other comprehensive income" have historically been understood in relation to an entity's ability to generate favorable cash flows. '*

The above statement reflects a misunderstanding because OCI recognition is not based on ability to generate favourable cash flows. CI is clearly defined Concept Statement 5.39 as "A broad measure....comprising all recognized changes in equity (net assets) of the entity during the period from transactions and other events and circumstances except those resulting from investments by owners and distributions to owners". CON 5 also states that "earnings and comprehensive income together reflect the extent to which the equity of an entity increased or decreased from all sources other than transactions with owners during the period". That's got nothing to do with cash flows; it includes unrealized gains and losses. There is no definition of OCI in the Concept Statements. CON 5 notes only that "certain items" are, in practice, in one place or the other, and notes that "... the reason for using comprehensive income rather than earnings in this Statement is that the Board has decided to reserve earnings for possible use to designate a different concept that is a component part - that is, is narrower than or less than comprehensive income".

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Hence, these conceptual considerations need to occur notwithstanding the backdrop of more items being included through the OCI through current projects, namely the IASB and FASB financial instruments projects and the IASB post employment benefits project.

## **SPECIFIC COMMENTS ON PROPOSED STANDARDS**

### ***Single Page/Continuous Presentation of Profit and Loss and Other Comprehensive Income Statement (IASB Question #2 and #5 and FASB Question #1, #4 and #5)***

We support this proposed change as it has the benefit of enhancing the usability of the reporting period's performance statement, and any opposition towards its implementation is not well founded. This proposal neither imposes significant implementation costs nor does it eliminate the net income and other currently provided profit and loss related information. Further, as noted earlier, while we also strongly encourage the development of a conceptual framework related to the purpose of OCI, it is hard to buy the argument posited in the IASB's alternative view, stating that a conceptual framework ought to be a precursor to this proposed presentation adjustment. This is simply a presentation adjustment and does not entail the provision of incremental information, nor does it delete existing information. It also has no significant cost implications for financial statement preparers.

### ***Change of Statement Title (IASB Question #1)***

The IASB is proposing renaming the statement of comprehensive income to 'statement of profit and loss and other comprehensive income' and FASB will retain the current name. We acknowledge that the IASB might be faced with the need to signal to its varied stakeholders that these changes are not paving way to the eradication of net income. However, the means of doing so should be based on substance rather than semantics. There is nothing in the proposed changes to suggest that net income statement information is going to be eliminated. Besides, given the objective of convergence, it is pointless to assign differing names for substantively equivalent financial statements and therefore we do not support this name change. Both Boards should retain the title of statement of comprehensive income.

### ***Presentation of Recycled Items (IASB Question #3 and FASB Question #3)***

Our opposition to recycling of items between net income and OCI stems from the difficulties that investors face in:

- Understanding why some items are recycled and others are not. This in turn limits the potential to accord differing economic meaning to items that have been recycled from those that have not;
- Assigning economic meaning to gains or losses that occur during one period but are only recognised in the income statement during another period.

Nevertheless, we support any change that enhances transparency of recycled items. For this reason, we support the differentiation and separate presentation between recycled and non-recycled items, as proposed by the IASB, as this in principle should help users to better distinguish between items of different earnings quality recorded in OCI. We also strongly support the proposal by FASB to require the display of reclassification adjustment for each component of OCI in both net income and OCI in the

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statement of comprehensive income and would recommend that the IASB should also require the provision of similar reclassification information.

However, despite supporting these changes, we reiterate that the ongoing application of recycling reinforces the need for a conceptual framework regarding OCI, as there currently is no overarching conceptual basis of determining whether or not items should be recycled.

#### ***Tax Allocation (IASB Question #4 and FASB Question #2)***

The IASB ED proposes to require that income tax on items presented in OCI should be allocated between items that might be subsequently reclassified to profit and loss, and those that will not be subsequently reclassified to profit and loss, if the items in OCI are presented before tax. The FASB ED proposes to allocate tax and present it either in the comprehensive income or in the notes in the financial statements.

In general, we support reporting of the tax effect of each component of the OCI. We acknowledge that despite the arbitrary nature of tax allocation, such information facilitates the forecasting of future cash flows. We would also favour the tax allocation to occur on the face of the comprehensive income statement rather than as a disclosure as allowed by FASB. Parallel to the allocation we would propose the disclosure of the basis of the tax allocation.

Similar to tax allocation, we would suggest that the splitting and display of the non controlling interest charge in the OCI, based on portions attributable to each individual item displayed on the OCI. This information presentation will help investors make better forecasts of future cash flows attributable to ownership interests.

#### ***Earnings Per Share (FASB Question #6)***

FASB proposes to retain the presentation of earnings per share (EPS) based on net income. We agree with the retention of the current EPS depiction, recognising that there are a significant number of users who apply this metric in their analytical process. However, we would also propose the inclusion of comprehensive income per share measure, for the benefit of users who use comprehensive income information as an input to their valuation. Both boards should implement the proposed presentation of EPS and comprehensive income per share information.

#### ***Transition (FASB Question #5)***

FASB intends to align effective date with the update for financial instruments. We agree that given the changes occurring in financial instruments that necessitate greater use of OCI, these changes that accord greater prominence to OCI items, should be aligned with the financial instruments updated implementation. However, the proposed OCI changes should not necessarily be linked to financial instrument changes and we would favour their immediate implementation. We also agree with the decision for the implementation of fully retrospective basis and the allowing of voluntary early adoption.

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IASB proposes that these changes should be applied immediately and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

### ***XBRL Matters***

We agree with FASB's proposal to update its XBRL taxonomy to reflect the changes proposed in the ED. We would urge the IASB to similarly update its XBRL taxonomy.

### **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, CFA, by phone at +44.207.531.0763, or by e-mail at [vincent.papa@cfainstitute.org](mailto:vincent.papa@cfainstitute.org), or Sandra Peters, CFA, by phone at +1.212.754.8350, or by e-mail at [sandra.peters@cfainstitute.org](mailto:sandra.peters@cfainstitute.org).

Sincerely,

*/s/Kurt N. Schacht*  
Kurt N. Schacht, CFA  
Managing Director

*/s/ Gerald I. White*  
Gerald I. White, CFA  
Chair, Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council

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## APPENDIX 1

### Illustrative Comprehensive Income Data from IFRS Compliant Companies

**Table 1: Illustrative Data (OCI recognition)**

Company	Year end	Currency	Net income	OCI	OCI/Net income
Alcatel Lucent	2009	Euros	<504.00>	573.00	114%
Allianz Re	2009	Euros	4,345.00	3,816.00	88%
Anglo American	2009	USD	2,912.00	3,097.00	106%
Barclays	2009	GBP	10,289.00	10,836.00	105%
BMW	2008	Euros	330.00	< 1,088.00 >	<330%>
BP	2009	USD	16,759.00	3,503.00	21%
British Airways	2009	GBP	< 358.00 >	<1,042.00 >	291%
Deutsche Bank	2009	Euros	4,958.00	1,085.00	22%
EADS	2009	Euros	<752.00>	407.00	<54%>
Fiat	2009	Euros	<848.00>	822.00	<97%>
HSBC	2009	USD	6,694.00	20,799.00	311%
Lufthansa	2009	Euros	<100.00>	35.00	<35%>
Nokia	2009	Euros	8,454.00	1,885.00	22%
Novartis	2009	USD	8,454.00	1,885.00	22%
RBS	2009	GBP	2,224.00	< 4,265.00>	<192%>

The above table, with data from several companies, shows that the annual OCI charge is materially significant and that investors need to pay attention to the OCI. The materiality shown in the table corroborates the finding of Moody's credit rating agency report<sup>6</sup> which found that OCI entries resulted in significant analytical adjustments to leverage for GE Capital. For the year 2004, effective leverage defined as (effective total debt excluding guaranteed sub debt/effective total equity) changed from 17.6 to 14.7.

<sup>6</sup> Moody's, April 2006, 'Moody's Approach to Other Comprehensive Income Items When Calculating Effective Leverage for Finance Companies'-Rating Methodology- Authors- Emrick.C, Wasden.M and Young.R