

**A SURVEY OF FORTUNE 500 COMPANIES' REPORTING OF  
COMPREHENSIVE INCOME**

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## **A SURVEY OF FORTUNE 500 COMPANIES' REPORTING OF COMPREHENSIVE INCOME**

The Financial Accounting Standards Board has issued Statement of Financial Accounting Standards No. 130 (FASB 130), "*Reporting Comprehensive Income*" in 1997. This Statement establishes standards for reporting and displaying comprehensive income and its components in a full set of general-purpose financial statements. In APB Opinion No. 9, "*Reporting the Results of Operations*," two income-reporting concepts are identified. Under the current operating performance concept, extraordinary and nonrecurring gains and losses are excluded from income and taken directly to stockholders' equity, thereby bypassing the income statement. Under the all-inclusive concept, all items of income or loss, including extraordinary and nonrecurring gains and losses, are included in income. APB Opinion No 9, adopted a modified all-inclusive view under which all gains and losses with the exception of prior period adjustments are reported in the income statement.

The FASB and earlier standard-setting bodies have deviated from a modified all-inclusive view for a few specific exceptions. For example, the cumulative effect on prior years of special changes in accounting principle were excluded from the income statement and taken directly to retained earnings. Under FASB 130, items that have been accounted for as a direct adjustment to equity must now be reported as "other comprehensive income." The purpose of this paper is to discuss the concept of comprehensive income, to analyze the display methods used by Fortune 500 companies for displaying comprehensive income, and to assess the financial statement impact of other comprehensive income.

## BACKGROUND

Comprehensive income is defined in Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements*, as "the change in equity of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distribution to owners." FASB 130 is effective for fiscal years beginning after December 15, 1997. Comprehensive income consists of net income and other comprehensive income. Other comprehensive income refers to revenues, expenses, gains, and losses that under generally accepted accounting principles are included in comprehensive income but excluded from net income. An enterprise that has no items of other comprehensive income in any period is not required to report comprehensive income.

FASB130 requires that all items meeting the definition of components of comprehensive income be reported in a financial statement for the period in which they are recognized" (Luecke, 1998). According to FASB 130, the following items should be reported as other comprehensive income:

1. Foreign currency translation adjustments;
2. Gains and losses on foreign currency transactions that are designated as economic hedges of a net investment in a foreign entity;
3. Gains and losses on intercompany foreign currency transactions that are of a long-term investment nature (consolidated, combined, or accounted for by equity method);

4. Changes in market value of a futures contract under FASB Statement No. 115;
5. Net loss recognized pursuant to FASB Statement No. 87 as additional pension liability;
6. Unrealized holding gains and losses on available-for-sale securities;
7. Unrealized holding gains or losses that result from a debt security being transferred from the held-to-maturity category to available-for-sale category; and
8. Subsequent decreases (if not an other-than-temporary impairment) or increases in the fair value of available-for-sale securities previously written down as impaired.

Additional classifications or additional items within current classifications of other comprehensive income may result from future accounting standards.

Prior to FASB 130, users of financial statements were concerned that the number of items bypassing the income statement was increasing (Foster, 1996). In fact, the FASB received requests to correct this deficiency from many prominent organizations, including The Association for Investment Management and Research; the Robert Morris Associates; and Michael H. Sutton (chief accountant of the SEC). In addition, there was international support for the reporting of comprehensive income. The United Kingdom Accounting Standards Board (ASB), issued Financial Reporting Standard No. 3. This Standard defines comprehensive income in a manner that is equivalent to the FASB's definition (Foster, 1996).

FASB 130 makes no changes to reporting net income or any of its major components. Since most cumulative accounting adjustments are currently displayed as a part of net income, the Board decided not to change that format. Their decision on this

issue was based primarily on the scope of FASB 130, which is the display of comprehensive income, and not the display of earnings.

FASB 130 provides three alternatives for displaying comprehensive income. Companies are encouraged to display the components of other comprehensive income below the net income total either in a statement reporting results of operations (one-statement approach) or in a separate statement of comprehensive income (two-statement approach). The third alternative is to display comprehensive income as part of the statement of changes in equity (Anderson, 1998). The FASB discourages using the statement of changes in equity method of display "because it hides comprehensive income in the middle of the financial statement." (Luecke, 1998)

Income tax expense or benefit is to be allocated to each component of other comprehensive income either on the face of or in the notes to the financial statements. The Board further allows each company to determine whether the components should be presented net of tax or show the accumulated total of comprehensive income before tax and the tax effect on a separate line.

The Board decided that all components of comprehensive income should be "reported in a financial statement that is displayed with the same prominence as other financial statements that constitute a full set of financial statements." However, it decided not to require presentation of comprehensive income as a measure of financial performance. A total for amount for comprehensive income must be displayed regardless of the format that an enterprise chooses. This information will enable readers of the statements to better understand the financial activities of a company.

In addition, use of the term comprehensive income was not mandatory, only that a descriptive label be used. As the Board expands its scope on the matter of comprehensive income, it may later require the use of this term in the financial statements. Additional items may also become included in the definition of comprehensive income in the future. Some possibilities include pensions and gains and losses on transactions in derivative instruments (Luecke, 1998). The original Exposure Draft also called for displaying per-share amounts for comprehensive income. However, the Board decided against making this a provision because several conceptual issues were not addressed in the Statement, and requiring earnings per-share amounts would be inconsistent with allowing a company to choose from the alternative display formats.

FASB 130 applies to all enterprises that provide a full set of financial statements; it does not apply to companies that do not have comprehensive income. It also does not apply to not-for-profit organizations. These organizations should continue to report the change in net assets for a period in a statement of activities (which shows an equivalent measure to comprehensive income) according to FASB Statement No. 117.

## **ANALYSIS OF ANNUAL REPORTS**

The data in this study were based on a review of annual reports of **Fortune 500** companies for 1999. The annual reports were analyzed to determine the format used to display comprehensive income (if reported) and to assess the financial statement impact of its presentation.

As Table 1 shows, 431 companies presented comprehensive income in their financial statements according to the guidelines set forth in FASB 130. Of these companies, 72 companies are utilizing the two-statement approach; 18 companies are using the one-statement approach; the remaining 341 companies are all disclosing comprehensive income using the change in equity method that the Financial Accounting Standards Board discourages but allows. Comprehensive income that is disclosed under the change in equity method lists foreign currency translation adjustment, change in unrealized gains (losses) on available-for-sale securities, and minimum pension liability as separate items.

(Insert Table 1 about here)

The impact on financial reporting of other comprehensive income may vary according to the format used for display. The one-statement approach ( a combined statement of net income and comprehensive income) may create the greatest potential for impact because many users of financial statements focus on the "bottom-line." Other formats for displaying comprehensive income will report the same measure of other comprehensive income, but its impact on financial statement analysis is not as evident. In this study impact will be measured by comparing other comprehensive income to net income. Other comprehensive income is deemed to have a "positive impact" when other comprehensive income is positive, and to have a negative impact when other comprehensive income is negative.

Most **Fortune** 500 companies' annual reports present up to three components of other comprehensive income: foreign currency translation adjustments, unrealized gains and losses in marketable securities, and minimum pension liability adjustments. Table 2 shows the impact on financial reporting of the reported amounts of other comprehensive income. As Table 2 shows, 153 companies have a positive reporting impact, and 273 companies have a negative reporting impact.

(Insert Table 2 about here)

When separating the **Fortune** 500 companies into industry groupings, a different pattern exists. Three industry groupings report, on average, a positive financial reporting impact: manufacturing; transportation, communication, electric, gas, and sanitary service; and service. On the other hand five industry groupings report, on average, a negative financial reporting impact: mining; construction; wholesale trade; retail trade; and finance, insurance, and real estate.

## **CONCLUSION**

The reporting of comprehensive income provides a more complete and picture of income, and its reporting makes the financial statements of U.S. companies more comparable with those in other countries. A large majority of **Fortune** 500 companies report comprehensive income using the statement of changes of equity approach. Although the change in equity approach is acceptable, the Financial Accounting Standards Board discourages using this method since components of other comprehensive income using this approach are buried within stockholders' equity.

The one-statement approach is not popular, perhaps because net income tends to be buried within comprehensive income. In addition, investors may not understand this approach, especially if they are accustomed to seeing net income as the bottom line. Recalculations may be needed because earnings per share will still be based on existing standards without regard to comprehensive income.

The two-statement approach leaves the income statement in its current form and adds a new statement of comprehensive income. This approach may be the most useful, especially for transition purposes. It is easy to understand, there is no need for recalculation of income to arrive at earnings per share, and investors will find it easier to understand. However, few enterprises use this approach because only four basic financial statements have traditionally been prepared.

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TABLE 1  
REPORTING FORMAT USED FOR REPORTING COMPREHENSIVE INCOME

	Number	Percent
Combined statement of net income and comprehensive income	18	3.6%
Separate statement of comprehensive income	72	14.4%
Part of statement of changes in stockholders' equity	341	68.2%
No comprehensive income reported	61	12.2%
Annual report not available	<u>8</u>	<u>1.6%</u>
Total	<u>500</u>	<u>100.0%</u>

TABLE 2  
FINANCIAL STATEMENT IMPACT OF OTHER COMPREHENSIVE INCOME

Impact:	Number	Percent
Positive	153	30.6%
Negative	273	54.6%
None	66	13.2%
Not available	<u>8</u>	<u>1.6%</u>
Total	<u>500</u>	<u>100.0%</u>