THE NEW BOTTOM LINE WILL TAKE YOU BY SURPRISE

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Grumpy Old Accountants, April 2012

Guest Column: Roman L. Weil (University of Chicago)

The bottom line has changed and you may not know it.

Have you ever heard of Other Comprehensive Income (OCI)? [25 percent of my audiences of managers, corporate lawyers and directors have.] Have you ever used OCI in making any decision? [About 20 percent of those who've heard of it have used it; that is about 5 percent of my audiences have ever used OCI to make a decision.]

Why do you care? Because starting now, the income statements you'll see will have a new bottom line. It will no longer be net income, but will be Comprehensive Income, which is conventional net income plus OCI.

See the top half of the accompanying exhibit, where net income (or earnings) is in the middle and Comprehensive Income is at the bottom. You might see a two statement approach, as in the bottom half of the exhibit.

What to do about the new OCI data? From my perspective, analysts need to understand that, just as with extraordinary items and discontinued operations, these items do not attract a price-earnings ("p.e.") multiple for valuation different from 1.00. Mindless use of conventional p.e. ratios will lead to nonsensical results.

If you think you can ignore OCI, then think about your reaction to the recent information that cities are going insolvent over their inability to pay pension costs. If municipal accounting had an equivalent of OCI and its balance sheet Accumulated Other Comprehensive Income, none of us would have been so taken by surprise. Accumulated Other Comprehensive Income is to OCI the way the Retained Earnings account on the balance sheet is to Net Income – Dividends.

ONE-STATEMENT APPROACH

Statement of Net Income and Comprehensive Income

Revenues		$100,000
Expenses		(25,000)
Gain on Sale of Securities		2,000
Other Gains and Losses		8,000
Earnings from Continuing Operations before Income Tax		$ 85,000
Income Tax Expense		(21,250)
Earnings before Discontinued Operations and Extraordinary Items		$ 63,750
Discontinued Operations, Net of Tax		30,000
Extraordinary Items, Net of Tax		(30,500)
Net Income (or, as preferred by the FASB, Earnings)		**$ 63,250**
Other Comprehensive Income, Net of Tax:		
Foreign Currency Translation Adjustments		7,000
Unrealized Gains and Losses on Securities:		
Unrealized Holding Gains Arising during Period	$13,000	
Less: Reclassification Adjustment for Gain Included in Net Income (Earnings)	(1,500)	11,500
Minimum Pension Liability Adjustment		(2,500)
Other Comprehensive Income (Loss)		**$ 16,000**
Comprehensive Income (Loss)		**$ 79,250**

TWO-STATEMENT APPROACH

Statement of Net Income

Revenues	$100,000
Expenses	(25,000)
Gain on Sale of Securities	2,000
Other Gains and Losses	8,000
Earnings from Continuing Operations before Income Tax	$ 85,000
Income Tax Expense	(21,250)
Earnings before Discontinued Operations and Extraordinary Items	$ 63,750
Discontinued Operations, Net of Tax	30,000
Extraordinary Items, Net of Tax	(30,500)
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Statement of Comprehensive Income

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How much time do you suppose will pass before the eye learns to focus on the number on the bottom, not the number in the middle? I'm guessing less than three years.

Here's the story. Managers like to control reported income. For two decades or so, the market rewarded managers who produce steadily growing income. The poster boy of this was Jack Welch at GE, who received praise and pay for reporting steadily growing quarter-over-quarter income for more than a decade.

During the last thirty years, accounting standard setters have realized that several factors, over which management has little control, can change a company's reported perform- ance. Consider, for example gains and losses on investments in a company's funds that support defined benefit pension plan. Or, its investments in securities it holds for pur- poses other than trading. Or, foreign exchange gains and losses from doing business in multiple currencies without being able to put on completely effective hedges. Account- ing refers to some items of this kind as components of "other comprehensive income."

Accountants know that such factors change wealth, but management cannot easily control them. Over time, managements have successfully pressured accounting standard setters to keep such gains and losses, as they occur, out of the conventional income statement. Still, accounting standard setters have resolved that financial statement readers be alerted to these changes in shareholder wealth. So for about 20 years, the standard setters have required that companies report on the components of OCI, then show the sum of conven- tional net income plus OCI as (Total) Comprehensive Income. But the reporting has been opaque.

Until recently, the standard setters allowed companies to present the components of OCI in such an obscure way that few noticed it or fewer still comprehended it. My favorite form of obfuscation was the format GE used until its 2008 statements, released in 2009, when it switched to a less confusing format, still not comprehensible to most readers, but better than before.

Starting now (in December 2011) companies must show OCI in parallel with conventional net income and the total of these two, Comprehensive Income, at the bottom.

Most companies will likely not call it Comprehensive Income, but use an alternative title allowed by the FASB, Total Changes in Shareholder Wealth from Transactions Other than With Owners, and will likely print the details of OCI on a page separate from, but following, the presentation of Earnings.

The two presentation formats used by the General Electric Company in recent years provide alternative formats that many companies will use. The bottom statement will be called Statement of Comprehensive Income or Statement of Changes in Shareholder Wealth from Transactions Other than With Owners.

Statement of Earnings

For the years ended December 31 (In millions; per-share amounts in dollars)	General Electric Company and consolidated affiliates 2009	2008	2007
REVENUES			
Sales of goods	$ 65,068	$ 69,100	$ 60,670
Sales of services	38,709	43,669	38,856
Other income (Note 17)	1,006	1,586	3,019
GECS earnings from continuing operations	—	—	—
GECS revenues from services (Note 18)	52,000	68,160	69,943
Total revenues	156,783	182,515	172,488
COSTS AND EXPENSES (Note 19)			
Cost of goods sold	50,580	54,602	47,309
Cost of services sold	25,341	29,170	25,816
Interest and other financial charges	18,769	26,209	23,762
Investment contracts, insurance losses and insurance annuity benefits	3,017	3,213	3,469
Provision for losses on financing receivables (Note 6)	10,928	7,518	4,431
Other costs and expenses	37,804	42,021	40,173
Total costs and expenses	146,439	162,733	144,960
EARNINGS (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	10,344	19,782	27,528
Benefit (provision) for income taxes (Note 14)	1,090	(1,052)	(4,155)
EARNINGS FROM CONTINUING OPERATIONS	11,434	18,730	23,373
Loss from discontinued operations, net of taxes (Note 2)	(193)	(679)	(249)
NET EARNINGS	11,241	18,051	23,124
Less net earnings attributable to noncontrolling interests	216	641	916
NET EARNINGS ATTRIBUTABLE TO THE COMPANY	11,025	17,410	22,208
Preferred stock dividends declared	(300)	(75)	—
NET EARNINGS ATTRIBUTABLE TO GE COMMON SHAREOWNERS	$ 10,725	$ 17,335	$ 22,208
AMOUNTS ATTRIBUTABLE TO THE COMPANY			
Earnings from continuing operations	$ 11,218	$ 18,089	$ 22,457
Loss from discontinued operations, net of taxes	(193)	(679)	(249)
NET EARNINGS ATTRIBUTABLE TO THE COMPANY	$ 11,025	$ 17,410	$ 22,208
PER-SHARE AMOUNTS (Note 20)			
Earnings from continuing operations			
Diluted earnings per share	$ 1.03	$ 1.78	$ 2.20
Basic earnings per share	1.03	1.79	2.21
Net earnings			
Diluted earnings per share	1.01	1.72	2.17
Basic earnings per share	1.01	1.72	2.18
DIVIDENDS DECLARED PER COMMON SHARE	$ 0.61	$ 1.24	$ 1.15

See Note 3 for other-than-temporary impairment amounts.

Consolidated Statement of Changes in Shareowners' Equity

(In millions)	2009	2008	2007
CHANGES IN SHAREOWNERS' EQUITY (Note 15)			
GE shareowners' equity balance at January 1	$104,665	$115,559	$111,509
Dividends and other transactions with shareowners	(5,049)	1,873	(23,102)
Other comprehensive income (loss)			
Investment securities—net	2,659	(3,218)	(1,484)
Currency translation adjustments—net	4,135	(11,007)	4,527
Cash flow hedges—net	1,598	(2,664)	(539)
Benefit plans—net	(1,804)	(13,288)	2,566
Total other comprehensive income (loss)	6,588	(30,177)	5,070
Increases from net earnings attributable to the Company	11,025	17,410	22,208
Comprehensive income (loss)	17,613	(12,767)	27,278
Cumulative effect of changes in accounting principles[a]	62	—	(126)
Balance at December 31	117,291	104,665	115,559
Noncontrolling interests[b]	7,845	8,947	8,004
Total equity balance at December 31	$125,136	$113,612	$123,563

On January 1, 2009, we adopted an amendment to ASC 810, *Consolidation*, that requires certain changes to the presentation of our financial statements. This amendment requires us to classify noncontrolling interests (previously referred to as "minority interest") as part of shareowners' equity.

(a) We adopted amendments to ASC 320, *Investments—Debt and Equity Securities*, and recorded a cumulative effect adjustment to increase retained earnings as of April 1, 2009. See Note 15.

(b) See Note 15 for an explanation of the change in noncontrolling interests for 2009.

See accompanying notes.

Statement of Earnings

For the years ended December 31 (In millions; per-share amounts in dollars)	General Electric Company and consolidated affiliates 2007	2006	2005
REVENUES			
Sales of goods	$ 60,670	$ 55,181	$ 50,727
Sales of services	38,856	36,329	32,839
Other income (note 3)	3,019	2,154	1,673
GECS earnings from continuing operations	—	—	—
GECS revenues from services (note 4)	70,193	58,179	51,341
Total revenues	172,738	151,843	136,580
COSTS AND EXPENSES (note 5)			
Cost of goods sold	47,309	43,279	39,169
Cost of services sold	25,816	23,494	20,615
Interest and other financial charges	23,787	18,896	14,811
Investment contracts, insurance losses and insurance annuity benefits	3,469	3,213	3,374
Provision for losses on financing receivables (note 13)	4,546	3,130	3,239
Other costs and expenses	40,297	35,639	33,278
Minority interest in net earnings of consolidated affiliates	916	862	916
Total costs and expenses	146,140	128,513	115,402
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	26,598	23,330	21,178
Provision for income taxes (note 7)	(4,130)	(3,950)	(3,824)
EARNINGS FROM CONTINUING OPERATIONS	22,468	19,380	17,354
Earnings (loss) from discontinued operations, net of taxes (note 2)	(260)	1,362	(634)
NET EARNINGS	$ 22,208	$ 20,742	$ 16,720
Per-share amounts (note 8)			
Per-share amounts—earnings from continuing operations			
Diluted earnings per share	$ 2.20	$ 1.86	$ 1.64
Basic earnings per share	2.21	1.87	1.64
Per-share amounts—net earnings			
Diluted earnings per share	2.17	2.00	1.57
Basic earnings per share	2.18	2.00	1.58
DIVIDENDS DECLARED PER SHARE	$ 1.15	$ 1.03	$ 0.91

Consolidated Statement of Changes in Shareowners' Equity

(In millions)	2007	2006	2005
CHANGES IN SHAREOWNERS' EQUITY (note 22)			
Balance at January 1	$111,509	$108,633	$110,181
Dividends and other transactions with shareowners	(23,102)	(17,983)	(13,249)
Changes other than transactions with shareowners			
Investment securities—net	(1,484)	(223)	(437)
Currency translation adjustments—net	4,527	3,649	(4,318)
Cash flow hedges—net	(539)	223	(47)
Benefit plans—net	2,566	287	(217)
Total changes other than earnings	5,070	3,936	(5,019)
Increases attributable to net earnings	22,208	20,742	16,720
Total changes other than transactions with shareowners	27,278	24,678	11,701
Cumulative effect of changes in accounting principles[a]	(126)	(3,819)	—
Balance at December 31	$115,559	$111,509	$108,633

(a) The effect of the 2006 accounting change was previously included in the caption "Benefit plans—net."

See accompanying notes.

You will not be able to avoid seeing OCI and Comprehensive Income, but you may not see it called that. This will change your life, whether you be manager deciding on transactions with income in mind, or analyst deciding what components of income are recurring, or corporate lawyer writing bond covenants based on accounting data, or labor negotiator deciding how much the company is earning, or legislator/regulator deciding what one can tax.

Now, is the time to start learning about it.

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This essay reflects the opinion of the authors and not necessarily the opinions of The Pennsylvania State University, The American College, or Villanova University.