



October 17, 2016

Via Email

FASB Invitation to Comment
Agenda Consultation
Technical Director
File Reference No. 2016-290

Dear Ladies and Gentlemen:

On August 4, 2016, the Financial Accounting Standards Board (FASB) issued an Invitation to Comment (ITC), *Agenda Consultation*, to solicit stakeholder feedback on which topics should be added to the FASB's agenda. The FASB has identified the following major financial reporting topics to include in this ITC:

- Intangible assets (including research and development)
- Pensions and other postretirement benefit plans
- Distinguishing liabilities from equity
- Reporting performance and cash flows (including income statement, segment reporting, other comprehensive income, and statement of cash flows).

This letter is submitted by the Risk Management Association ("RMA" or the "Association") in respect of the financial reporting issues that the FASB should consider adding to its agenda. In this regard RMA is responding to the issues regarding reporting performance and cash flows, potential standard setting alternatives and the topic-specific questions related to the income statement and to other comprehensive income.

Background

RMA is a 501(c) (6) not-for-profit, member-driven professional association whose sole purpose is to advance the use of sound risk management principles in the financial services industry. RMA helps its members use sound risk principles to improve institutional performance and financial stability and enhance the risk competency of individuals through information, education, peer-sharing, and networking. RMA has 2,600 institutional members that include banks of all sizes as well as nonbank financial institutions. They are represented in the Association by more than 18,000 risk management professionals who are chapter members in financial centers throughout North America, Europe, and Asia/Pacific.

One of the most important components of RMA's mission is to provide independent analysis on matters pertaining to risk management and capital regulation. In this regard the comments contained herein are informed by subject matter experts from member institutions of the Association, including participants in RMA's Accounting Committee.

RMA offers its observations on two items in your proposed statement of financial accounting concepts: (1) financial statement reporting of performance and cash flows and (2) other comprehensive income.

(1) Financial Statement Reporting of Performance and Cash Flow Information

Overview

The main objective of financial statements is providing its users with actionable information that requires minimal adjustments to support sound decisions, whether as a creditor or investor. We agree with the FASB that predicting future earnings is a key objective, and that the aggregation of supporting data is made across too few lines.

We find one of the most useful statements to be the statement of cash flow because we rely on recurring cash flow to repay debt. We contend that a more decision-useful cash flow statement, however, depends on a better articulated income statement. Key concepts here include recurring income, income from operations, fixed and variable costs, and income derived from fair valuing of assets. The ability to separate recurring from non-recurring activities is essential to predicting future cash flows accurately. As the Board is aware, this issue has persisted for quite some time. In a 1991 ABACUS study, Cameron and Stephens hypothesized that "the current ABP 30 requirement to classify items of a nonrecurring nature in the operating section of the income statement decreases the predictive ability of income before extraordinary items."

Heightened comparability across similar companies and transactions with similar economics is also of crucial importance. We need to be able to trace the impact of a particular transaction or class of transactions across the three statements comprising the financial package to understand how they link to one another. We recognize that while providing perfect linkage would be a broad project, FASB should consider users' needs for comparability as we address the various questions posed in this Invitation to Comment.

Another critical concept for the Board to keep in focus is the complete transaction. Too often transactions that have the same economic effect are presented differently in the various statements, for example, the treatment of leases. Different presentations diminish or limit transparency and comparability, ultimately impacting the decisions we make based on financial statements.

Question 4.1: Is income statement presentation a major financial issue that the FASB should consider for improvement? Please explain why?

The income statement certainly warrants improvement. The current template offers very little to no comparability because of the latitude afforded to management in defining items such as cost of goods sold and administrative costs. Ideally, the income statement should focus on revenue sources and cost drivers. Most users would find the income statement information more useful if it were separated into recurring and nonrecurring activities and further separated into fixed and variable costs. We recognize that, in practice, this suggestion

may be difficult to implement given the additional time and resources required to bifurcate the two activities and the two costs, but the value to both the client and its creditors should be self-evident, e.g., cash flow and break-even analysis. Further, we recommend that the effects of fair valuing of assets and liabilities be removed from the operating income section to clarify recurring operating cash flows. The concept of financial statement linkage, comparability, transparency, fair presentation and presenting decision-useful information with minimal manipulation are the criteria on which we base this recommendation.

Question 4.2: How should the components of net income be categorized, if at all? If the FASB were to develop an operating activities category and display a subtotal for operating income, how should the category be defined or described?

As we have previously stated, the ability to bifurcate recurring and nonrecurring activities on the income statement is essential to understanding cash flow properly. We believe the components of net income should be categorized in such a manner that allows users to discern these items reasonably. Simply stated, net income could be categorized into a recurring and nonrecurring section. The former would represent all activities that can be expected to recur in each reporting period and with reasonable predictability. The latter section would include all other activities before income tax, including fair value re-measurements, discontinued operations, restructuring charges, and other items deemed to occur infrequently. We understand the challenges this poses, especially given the perceived differences between financial operators and commercial industrial operators. However, too often users of financial statements must make material adjustments based on the users' own assumptions because of the lack of sufficient transparency. If the income statement were bifurcated as recommended, companies would have less reason to resort to non-GAAP earnings alternatives.

Question 4.3: Could an operating activity category be defined or described consistently and effectively for all types of reporting entities (for example, entities involved in financial services, investing, banking, and financing)?

Given the FASB's single definition of revenue recognition, it stands to reason that the Board could also provide a categorical definition for operating activities. Such a definition would need to take into account how operating activities differ from one industry to another, for example, the distinction between financial versus commercial and industrial operators. A global definition of operating activities would be a very broad project, but its successful completion would significantly improve financial statement comparability. Otherwise, we will continue to struggle with the possibility of financial statements being subjected to manipulation and consequent misinterpretation by their users.

Question 4.4: How should the FASB evaluate the benefits of a standardized definition versus a management determination of an entity's operating activities?

This is a classic agency issue, though the answer lies in who the users of financial statements are. Management can present data in many ways relative to its own decision-making, but the needs of financial statements users should be the aim of the FASB and SEC. We contend that users of financial statements—especially creditors—want and need consistency and comparability. In addition to the benefits the users will realize from greater consistency and comparability, the costs/additional resources of the preparers will also benefit from the efficiencies inherent in consistency.

Question 4.5: Which, if any, of the three alternatives described for combining or separating items provides more useful information to users of financial statements, and why?

Alternative B appears to be the most logical because it will separate the re-measurement changes and other non-frequent costs or revenues. We creditors focus on recurring income and costs in our credit analyses, and because of the increased use of fair value measures, separating fair valuation churn clarifies the recurring streams.

Question 4.6: Are there other alternatives for presenting lines within the income statement that the FASB should consider?

Refer to our response to Question 4.2 above.

Question 4.15: Is the presentation of cash flows a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

Yes, the statement of cash flows (SOCF) is a major reporting issue we recommend FASB consider. The income statement provides users of financial information with the ability to analyze earnings, and the SOCF allows users to validate noncash items impacting EBITDA, including depreciation and amortization, and to analyze cash payments for items such as taxes and cash outflows to owners. As creditors, we are concerned with cash resources available to meet tax liabilities, contractual debt obligations and shareholder income. We contend that in order to sufficiently address the financial reporting issues contained in the SOCF, the income statement presentation must also be on the agenda.

Question 4.16: Do you recommend that the FASB retain or reconsider the three-category structure and the definitions of operating, investing, and financing activities within the statement of cash flows?

FASB's three-category approach attempts to meet the needs of users and clients, FASB ought to sharpen the definitions of the current three categories. For example, operating cash flow is treated as a kind of residual category after financing and investing flows. Yet to the lending community, operating cash flow is the lifeblood of the repayment stream. It would definitely be of benefit to classify operating cash flow as recurring and nonrecurring.

Question 4.17: What specific cash flows should be disaggregated in the future that are not being disaggregated today and is that disaggregation feasible?

There are several feasible disaggregation items that should be considered. The first is expansionary capital expenditures versus maintenance CapEx. Management knows this information and can share it with its preparer. Another is sources of revenue, e.g., revenue from core operations, revenue from sale of assets, revenue from financing customers, and miscellaneous revenues. This approach may be easier for companies to provide than recurring and nonrecurring categories, but our user preference would be to delineate recurring from nonrecurring revenue. This separation would make it easier to differentiate core from non-core and so improve the quality of earnings and decrease the need for non-GAAP reporting.

Question 4.18: What specific cash payments and receipts are in need of additional classification guidance?

There are several cash payments and receipts that would benefit from clarification. Financial institutions' trading of securities is an operating activity, but it is not for commercial and Industrial companies. Consequently, this difference in treatment makes it relatively easy for a C&I company to manipulate cash flow from operations by moving funds from trading securities to cash equivalents which are treated as part of cash rather than investments. Another item is accounts receivable financing. Receivables can be financed by borrowings with the receivables pledged as collateral. The monies received are considered a financing activity, but this has been replaced by the sale of receivables with or without recourse to keep debt off the balance sheet. Economically this activity still represents a form of financing, but yet is considered part of operating cash flow. Another problem is the treatment of dividends received as an operating activity rather than investing activity when a company has a significant investment in affiliated companies. This gives the company the ability to manipulate its own cash from operations by simply increasing the dividends it receives from the affiliates. A final example is taxes treated as an operating activity, even when they are incurred on large security gains that are included in investment activity. This violates the "matching principle." These kinds of inconsistencies warrant FASB's remediation.

Question 4.23: What type of project or projects do you recommend that the FASB prioritize to improve reporting of performance and cash flow information? If you recommend multiple projects or different combinations, please explain the recommended sequencing of those projects.

We recommend FASB consider both projects. However, if resource constraints prevent that, we would encourage FASB to pursue the narrow project articulated as follows:

- Narrow project to consider is the statement of cash flow including targeted improvements to provide disaggregation of recurring and nonrecurring cash flow and redefining the existing three classifications of activities shown in the statement of cash flow:
 - This project would improve transparency and our understanding of recurring and non-recurring cash flows.
- Holistic project that provides linkages among the income statement, balance sheet, and statement of cash flows.

Question 4.24: What issues and solutions should be addressed within those projects?

Each constituency of users has its unique needs. FASB needs to arrive at a solution that will satisfy user wants and needs at a reasonable cost to preparers and their clients.

(2) Other Comprehensive Income

Overview

Other comprehensive income (OCI) continues to be a debated topic because of its presentation method within financial reporting standards. Resource updates and articles provide great insights into what the issues have been and what the resolution reporting format may look like.

OCI is described as a more in-depth view of net income. Specifically, it represents those items that are considered outside of a company's core business activities. The premise of

OCI is that these sources of income are often volatile and beyond the normal controls of management. For these reasons, OCI sources are reported as a sub-component of equity and are not typically reported within the income statement. Noteworthy components of OCI are listed as follows:

- Unrealized gain/loss of available for sale (AFS) securities.
- Gain/loss associated with cash flow hedge derivative products.
- Gain/loss associated with translating financial reporting of foreign owned subsidiaries (foreign currency translation).
- Gains/losses associated with defined benefit plans.

Like retained earnings, these OCI elements are accumulated from reporting period to reporting period (known as AOCI). As certain flow criteria are met within accounting standards, affected OCI items are re-classified into the income statement and resulting P&L reporting.

Financial reporting stakeholders have expressed concern that stand-alone accumulated OCI can lose detail and relevance as re-classified amounts migrate over time into corresponding line items within the income statement. Some contend that *flow* items should be reported within earnings (income statement) but *stock* (snapshot) items continue to be reported within the equity section of the balance sheet. However, an example of keeping a *flow* item a component of AOCI can be found in the banking industry.

When recession struck in 2008, bank investment portfolios experienced significant losses. Since these securities losses were deemed OCI/AOCI events by SEC guidance for major publicly traded banks, retained earnings, and its direct relationship to tier I capital reporting, were left intact and regulatory capital standards were not immediately violated. This alone would be a strong reason as to why OCI presentation ought to be reconsidered. While some argue that imposing OCI factors upon normal business earnings creates volatility and unpredictable outcomes for projection scenarios, our concern is that including OCI items in earnings obscures the basic business core dynamics occurring within a company's assets and liabilities.

The pro/con positions give rise to the reporting of comprehensive income, which is the combination of net income and OCI. There have been two reporting methods proposed and favored for comprehensive income. One is to begin with revenues and end with comprehensive income all in one statement. A second recommended format would be a schedule that begins with net income, adds OCI components, and sums to a total comprehensive income.

It seems practical that the net income plus detailed OCI activity would be a preferred means of stating comprehensive income for the banking industry. It would leave the income statement representing the fundamental business activity of an entity while further introducing OCI influences to which a business may be exposed. This could provide a clearer picture of the micro and macro environment to which a business may be exposed.

Stakeholders will have many varying motivations in using this information, e.g., business valuation given future perceived risk, business repayment capacity given future perceived risk, return analysis, business risk appetite. By splitting the information between two statements, the income statement earnings activity and the OCI detail remain separate so that various stakeholders can more easily apply their specific analysis objectives to the

reported information. Due to the many potential interpretations of this information, *performance* may very likely have multiple definitions among the various constituents.

Question 4.11: Is the presentation of OCI a major financial reporting issue that the FASB should consider for improvement?

Yes. It provides a deeper depiction of potential earnings performance and risk environment of a business.

Question 4.12: Considering the two alternatives described for minimizing the use of reclassification adjustments, which alternative provides more useful information to users of financial statements?

Comprehensive income spread over two statements. This would provide a view of core business fundamentals and earnings activity before imposing and assessing the impacts from OCI variables.

Question 4.13: Do the described improvements to (a) remove the option for presenting comprehensive income over two statements and (b) emphasize other earnings per share measures improve the relevance of the performance information included in OCI?

Yes. Due to the wide array of stakeholders with differing performance models, the proposed change would take OCI items from their relatively obscure position as a subset of balance sheet equity and place them within more appropriate sections of financial reporting.

If you have any questions concerning the comments above, please contact Mark A. Zmiewski, director, RMA at mzmiewski@rmahq.org, 215-446-4085.

Very truly yours,



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