

Financial Accounting

Income Statement Structure

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Income Statement Structure

BGS Technologies
Income Statement
Year Ended March 31, 2018

| | |
|--|-------------------|
| Sales | \$ 1,000,000 |
| Cost of goods sold | <u>550,000</u> |
| Gross profit | 450,000 |
| Research and development expense | 100,000 |
| Selling, general and admin. expenses | <u>150,000</u> |
| Operating income | 200,000 |
| Other income (expense): | |
| Special item - Lawsuit settlement | (125,000) |
| Special item – Loss from flood | (25,000) |
| Interest income | 50,000 |
| Interest expense | <u>(25,000)</u> |
| Income from continuing operations before taxes | 75,000 |
| Income tax provision | <u>18,750</u> |
| Income from continuing operations | 56,250 |
| Gain from discontinued operations (net of tax) | <u>110,250</u> |
| Net Income | \$ <u>166,500</u> |

Definitions:

Special Items – An item that is nonrecurring in nature for the company given its industry, location or environment. Nonetheless, the item isn't expected to recur. Reported as component of other income within Income from Continuing Operations. Not reported net of income tax.

Example: Lawsuit settlement.

Example: Writedown of slow-moving inventory.

Extraordinary Items - unusual and nonrecurring gain or loss. No longer a separate line item on the income statement. Such items, including gains and losses that historically would have been considered to be extraordinary, are now reported as a separate line of other income within income from continuing operations.

Example: Loss from fire.

Example: Earthquake damage - likely not extraordinary for a company based in Los Angeles.

Discontinued Operations - income or loss from discontinued business segment, including gain or loss on disposal. Involves exiting a line-of-business entirely or disposal of a separate reporting unit. Reported separately, net of income tax.

Example: Philip Morris disposes of Kraft Foods.

Income Statement Structure Illustrated
Nonrecurring Items
ABEC Telecommunications, Inc.

| (In thousands) | <u>2018</u> | <u>2017</u> |
|-------------------------------------|----------------|----------------|
| Net sales | \$ 586,222 | \$ 448,735 |
| Cost of products sold | <u>302,094</u> | <u>221,448</u> |
| Gross Profit | <u>284,128</u> | <u>227,287</u> |
| Expenses: | | |
| Development and product engineering | 66,460 | 48,974 |
| Selling and administration | 130,297 | 110,799 |
| Goodwill amortization | 3,133 | 3,135 |
| Personnel reduction | <u>3,914</u> | <u>--</u> |
| Total expenses | <u>203,804</u> | <u>162,908</u> |
| Operating Income | 80,324 | 64,379 |
| Other income (expense), net | <u>5,905</u> | <u>(58)</u> |
| Income before taxes | 86,229 | 64,321 |
| Provision for income taxes | <u>31,043</u> | <u>23,800</u> |
| Net income | <u>55,186</u> | <u>40,521</u> |

ABEC Telecommunications, Inc. (cont'd)

Personnel Reduction: During the quarter ended April 30, 2018, the Company initiated a realignment of its Kentrox and Fibermux subsidiaries into one business unit. The Company recorded a charge of \$3,914,000 in conjunction with the realignment, related primarily to a personnel reduction. As a result of the realignment, approximately 100 Fibermux employees, primarily in sales, administration and engineering, were separated from the Company.

The charge for personnel reduction is a nonrecurring item. Typically, such items are reported as a separate line item outside of operating income. In this case, the nonrecurring item is reported as part of operating income.

Income Statement Structure Illustrated
Discontinued Operations
Computer Dynamics Corp.

| | <u>2017</u> | <u>2016</u> |
|--|-----------------|-----------------|
| Net sales | \$ 10,308 | \$ 9,699 |
| Cost of goods sold | <u>8,792</u> | <u>8,113</u> |
| Gross margin | 1,516 | 1,586 |
| Selling, general and administrative expenses | 1,214 | 1,095 |
| Research and development | <u>359</u> | <u>66</u> |
| Operating income (loss) | <u>(57)</u> | <u>425</u> |
| | | |
| Other (income) expense | | |
| Interest expense | 31 | 21 |
| Interest income | (9) | (28) |
| Other (income) expenses | <u>186</u> | <u>(1,662)</u> |
| Total other (income) expense | <u>208</u> | <u>(1,669)</u> |
| | | |
| Income (loss) from continuing operations | | |
| before income taxes | (265) | 2,094 |
| Income tax provision (benefit) | <u>(55)</u> | <u>29</u> |
| Income (loss) from continuing operations | (210) | 2,065 |
| | | |
| Discontinued Operations: | | |
| | | |
| Loss from discontinued operations | (352) | (860) |
| Loss on disposal of discontinued operations | <u>(101)</u> | <u>-</u> |
| Loss from discontinued operations | <u>(453)</u> | <u>(860)</u> |
| | | |
| Net Income (loss) | \$ <u>(663)</u> | \$ <u>1,205</u> |

Divestiture of Suntec Division

On August 21, 2017, Quanta Systems transferred all of the assets and liabilities of Quanta Systems's Suntec division to Suntec Service Corporation, a newly-formed corporation ("Suntec"), in return for (i) all of Suntec's issued and outstanding common stock and (ii) Suntec's agreement to pay to Quanta Systems a royalty of 2% of Suntec's net sales and other revenues for thirty (30) years from the date of the closing.

As a result of the disposal of Suntec in 2017, the consolidated statements of operations for the year ended December 31, 2016 has been restated to reflect Suntec as a discontinued operation. Loss from Discontinued Operations includes a provision of \$101 thousand in 2017 for the loss on disposal. Revenues included in loss from discontinued operations, were \$656 thousand, and \$2.588 million in 2017 and 2016, respectively.

Discontinued operations include income from operations of the discontinued segment plus a gain or loss on disposal. Note the restatement of prior-year results to conform with current year presentation.

Other Comprehensive Income

Comprehensive income includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

In particular, comprehensive income includes net income, as traditionally defined, plus four items:

- Adjustments for underfunded and overfunded pension plans
- Unrealized gains and losses on available-for-sale debt securities
- Cumulative foreign currency translation gains and losses
- Certain derivatives-related gains and losses

Accumulated amounts for these items are reported directly in shareholders' equity, in a section termed Accumulated Other Comprehensive Income.

Separate disclosure of comprehensive income (net income plus other comprehensive income) is required in either single continuous statement or in two separate, but consecutive statements.

Comprehensive income disclosed in a Separate Statement
(most companies employ this approach)

Enterprise
Statement of Comprehensive Income
Year Ended December 31, 2016

| | |
|--|------------------|
| Net income | \$ 63,250 |
| Other comprehensive income: | |
| Foreign currency translation | \$ 8,000 |
| Available-for-sale securities (\$13,000 unrealized holding gains less \$1,500 in gains included in net income) | 11,500 |
| Pension plan adjustment | (2,500) |
| Other comprehensive income | <u>17,000</u> |
| Comprehensive income | \$ <u>80,250</u> |

Where on the Income Statement?

Several special income statement and other comprehensive income items are provided below. For each item, decide if it should be reported:

“O” - as a nonrecurring item on the income statement within income from continuing operations.

“D” - as a discontinued segment on the income statement.

“OCI” – as a component of other comprehensive income.

1. A foreign currency *transaction* loss of \$14.3 million. (Dekalb Genetics).

Where is it reported? _____.

2. Litigation charge of \$10.9 million. (U.S. Home).

Where is it reported? _____.

3. Loss of \$4.9 million on an FTC ordered divestiture of seven previously acquired bakery companies. (Flowers Industries, a bakery company).

Where on the Income Statement? _____.

4. A foreign currency *translation* gain of \$587,951. (Profire Energy, Inc).

Where is it reported? _____.

5. Gain of \$1.7 million on the early retirement of debentures. (Kulicke and Soffa Industries).

Where is it reported? _____.

6. Unrealized gain of \$1 million on available-for-sale debt securities (Intuit, Inc.).

Where is it reported? _____.

7. Loss of \$4.4 million from the impact of a state wide freeze in Florida on some of its non-fruit bearing and mature trees. (Orange-Co, Inc.).

Where on the Income Statement? _____.

8. Gain of \$127 million from the sale of its consumer paint, industrial coatings, surfactants, and emulsifiers businesses. After these sales, the company operates in a single segment -- the manufacture of detergents. (DeSoto, Inc.).

Where on the Income Statement? _____.

9. A estimated loss of \$41 billion arising from the cost of cleaning up a multi-million gallon oil spill in the Gulf of Mexico (BP, Inc.)

Where on the Income Statement? _____.

**Changes in Accounting Principle
All Reported as a Restatement with
Retroactive Adjustment to Retained Earnings**

**Basic Industries
(000s)**

**Income Statement and Statement of Retained earnings,
As originally reported, December 31, 2016 financial statements**

Y/E December, 31, 2016

| | |
|---|------------------|
| Sales | \$ 82,914 |
| Cost of sales | <u>49,748</u> |
| Gross profit | 33,166 |
| Operating expenses | <u>20,729</u> |
| Operating income | 12,437 |
| Other income | <u>819</u> |
| Income before income taxes | 13,256 |
| Income tax provision | <u>4,807</u> |
| Net income | <u>\$ 8,449</u> |
| | |
| Retained earnings Dec. 31, 2015 | \$ 71,770 |
| Net income for year ended Dec. 31, 2016 | 8,449 |
| Dividends for year ended Dec. 31, 2016 | <u>(3,500)</u> |
| Retained earnings Dec. 31, 2016 | <u>\$ 76,719</u> |

Basic Industries (cont'd)
(000s)

Income Statement as Restated

December 31, 2017 financial statements . . .

| | Y/E Dec. 31, 2017 | Y/E Dec. 31, 2016 (As Restated, See note 2) |
|----------------------------|-------------------|--|
| Sales | \$ 91,205 | \$ 82,914 |
| Cost of sales | <u>54,722</u> | <u>49,748</u> |
| Gross profit | 36,483 | 33,166 |
| Operating expenses | <u>21,307</u> | <u>19,458</u> |
| Operating income | 15,176 | 13,708 |
| Other income | <u>910</u> | <u>819</u> |
| Income before income taxes | 16,086 | 14,527 |
| Income tax provision | <u>5,759</u> | <u>5,268</u> |
| Net income | <u>\$ 10,327</u> | <u>\$ 9,259</u> |

Statement of Retained Earnings as Restated

Dec. 31, 2017 financial statements . . .

| | |
|--|------------------|
| Retained earnings, Dec. 31, 2015, as originally reported | \$ 71,770 |
| Adjust beg. bal. for prior-years effect of accounting change | <u>15,552</u> |
| Adjusted balance, Dec. 31, 2015 | 87,332 |
| Net income for year ended Dec. 31, 2016, as restated | 9,259 |
| Dividends for year ended Dec. 31, 2016 | <u>(3,500)</u> |
| Retained earnings, Dec. 31, 2016 as restated | \$ 93,081 |
| Net income for year ended Dec. 31, 2017 | 10,327 |
| Dividends for year ended Dec. 31, 2017 | <u>(3,500)</u> |
| Retained earnings, Dec. 31, 2017 | <u>\$ 99,908</u> |

Note 2.

Effective January 1, 2017, the Company adopted the prevailing industry practice which is to capitalize spare parts when purchased and, upon their later use, to charge them to expense. Previously spare parts were expensed when purchased. Financial statements for the year ended Dec. 31, 2016 were restated to reflect this change in accounting. The cumulative effect of the change on net income of years prior to the year ended Dec. 31, 2016 in the amount of \$15,552 is reflected as a retroactive adjustment to the balance in retained earnings as of Dec. 31, 2015. The effect of this change on 2017 and 2016 operations was to increase net income by \$1,555 and \$810, respectively.

Accounting Change (T/F)
Basic Industries

1. Income from continuing operations in 2017 was \$15,176.
2. The change in accounting for spare parts inventories increased net income reported in the 2016 income statement, as restated, by a total of \$ 810.
3. The change in accounting for spare parts inventories increased net income reported in the 2017 income statement by a total of \$1,555.
4. The 2017 change in the accounting for spare parts reduced Ideal Basic's 2017 ratio of debt to equity.

