Financial Accounting

Income Statement Structure

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Income Statement Structure

BGS Technologies
Income Statement
Year Ended March 31, 2016

Sales	$ 1,000,000
Cost of goods sold	550,000
Gross profit	450,000
Research and development expense	100,000
Selling, general and admin. expenses	150,000
Operating income	200,000
Other income (expense):	
Nonrecurring item - Lawsuit settlement	(150,000)
Interest income	50,000
Interest expense	(25,000)
Income from continuing operations before taxes	75,000
Income tax provision	28,500
Income from continuing operations	46,500
Gain from discontinued operations (net of tax)	120,000
Net Income	$ 166,500

Definitions:

Nonrecurring Items – A special item of income or expense, gain or loss, that is not unusual 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 and Extraordinary Items
ABEC Telecommunications, Inc.

(In thousands)	2015	2014
Net sales	$ 586,222	$ 448,735
Cost of products sold	302,094	221,448
Gross Profit	284,128	227,287
Expenses:		
Development and product engineering	66,460	48,974
Selling and administration	130,297	110,799
Goodwill amortization	3,133	3,135
Personnel reduction	3,914	--
Total expenses	203,804	162,908
Operating Income	80,324	64,379
Other income (expense), net	5,905	(58)
Income before taxes and extraordinary item	86,229	64,321
Provision for income taxes	31,043	23,800
Net income before extraordinary item	55,186	40,521
Extraordinary item, net of taxes	--	(1,450)
Net income	$ 55,186	$ 39,071

ABEC Telecommunications, Inc. (cont'd)

Personnel Reduction: During the quarter ended April 30, 2015, 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.

Extraordinary Item: The building that serves as headquarters for Fibermux suffered damage as a result of an earthquake. The facility sustained damages of $2,300,000 ($1,450,000 after the $850,000 tax benefit).

Evident here is the role of judgment in deciding whether or not items are to be classified as extraordinary.

Given the likelihood of earthquake damage in Los Angeles, one would typically not expect such a loss to be classified as an extraordinary item.

Management does not consider the personnel reduction charge to be unusual and accordingly, it is not reported as an extraordinary item.

Income Statement Structure Illustrated
Discontinued Operations
Computer Dynamics Corp.

	2015	2014
Net sales	$ 10,308	$ 9,699
Cost of goods sold	8,792	8,113
Gross margin	1,516	1,586
Selling, general and administrative expenses	1,214	1,095
Research and development	359	66
Operating income (loss)	(57)	425
Other (income) expense		
Interest expense	31	21
Interest income	(9)	(28)
Other (income) expenses	186	(1,662)
Total other (income) expense	208	(1,669)
Income (loss) from continuing operations before income taxes and extraordinary item	(265)	2,094
Income tax provision (benefit)	(55)	29
Income (loss) from continuing operations before extraordinary item	(210)	2,065
Discontinued Operations:		
Loss from discontinued operations	(352)	(860)
Loss on disposal of discontinued operations	(101)	-
Loss from discontinued operations	(453)	(860)
Income (loss) before extraordinary item	(663)	1,205
Extraordinary item	-	523
Net income (loss)	$ (663)	$ 1,728

Computer Dynamics Corp. (Cont'd)

Divestiture of Suntec Division
On August 21, 2015, 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 2015, the consolidated statements of operations for the year ended December 31, 2014 has been restated to reflect Suntec as a discontinued operation. Loss from Discontinued Operations includes a provision of $101 thousand in 2015 for the loss on disposal. Revenues included in loss from discontinued operations, were $656 thousand, and $2.588 million in 2015 and 2014, 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.

Where on the Income Statement?

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

"O" - as a nonrecurring item within income from continuing operations.
"D" - as a discontinued segment.
"E" - as an extraordinary item.

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

   Where on the income statement? _____.

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

   Where on the Income Statement? _____.

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

   Where on the Income Statement? _____.

Where on the Income Statement? (cont'd)

5. 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? _____.

6. 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? _____.

7. 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, 2014 financial statements

	Y/E December, 31, 2014
Sales	$ 82,914
Cost of sales	49,748
Gross profit	33,166
Operating expenses	20,729
Operating income	12,437
Other income	819
Income before income taxes	13,256
Income tax provision	4,807
Net income	$ 8,449
Retained earnings Dec. 31, 2013	$ 71,770
Net income for year ended Dec. 31, 2014	8,449
Dividends for year ended Dec. 31, 2014	(3,500)
Retained earnings Dec. 31, 2014	$ 76,719

Basic Industries (cont'd)
(000s)

Income Statement as Restated
December 31, 2015 financial statements . . .

	Y/E Dec. 31, 2015	Y/E Dec. 31, 2014 (As Restated, See note 2)
Sales	$ 91,205	$ 82,914
Cost of sales	54,722	49,748
Gross profit	36,483	33,166
Operating expenses	21,307	19,458
Operating income	15,176	13,708
Other income	910	819
Income before income taxes	16,086	14,527
Income tax provision	5,759	5,268
Net income	$ 10,327	$ 9,259

Statement of Retained Earnings as Restated
Dec. 31, 2015 financial statements . . .

Retained earnings, Dec. 31, 2013, as originally reported	$ 71,770
Adjust beg. bal. for prior-years effect of accounting change	15,552
Adjusted balance, Dec. 31, 2013	87,332
Net income for year ended Dec. 31, 2014, as restated	9,259
Dividends for year ended Dec. 31, 2014	(3,500)
Retained earnings, Dec. 31, 2014 as restated	$ 93,081
Net income for year ended Dec. 31, 2015	10,327
Dividends for year ended Dec. 31, 2015	(3,500)
Retained earnings, Dec. 31, 2015	$ 99,908

Note 2.
Effective January 1, 2015, 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, 2014 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, 2014 in the amount of $15,552 is reflected as a retroactive adjustment to the balance in retained earnings as of Dec. 31, 2013. The effect of this change on 2015 and 2014 operations was to increase net income by $1,555 and $810, respectively.

Accounting Change (T/F)
Basic Industries

1. Income from continuing operations in 2015 was $15,176.

2. The change in accounting for spare parts inventories increased net income reported in the 2014 income statement, as restated, by a total of $ 810.

3. The change in accounting for spare parts inventories increased net income reported in the 2015 income statement by a total of $1,555.

4. The 2015 change in the accounting for spare parts reduced Ideal Basic's 2015 ratio of debt to equity.

Where on the Income Statement?

The following items were taken from the income statements of the identified companies.

Indicate where on the income statement items are expected to be found. You have the following choices:

Within income from continuing operations, "O".

As a component of discontinued operations, "D".

As an extraordinary item, "E".

As a prior-period adjustment to retained earnings, "RE".

The items:

1. **Eli Lilly.** A $2.4 billion charge against earnings to write down by more than half the value of a $4.1 billion investment in PCS Health Systems.

2. **Columbus McKinnon Corp.** The Company repurchased certain of its outstanding notes payable at a premium and redeemed $69,480,000 of the $70,000,000 face value that was outstanding.

3. **Able Telcom Holdings.** Historically, the Company has experienced severe earnings volatility relating to its Latin American operations, primarily as a result of foreign currency devaluations and currency exchange controls. To mitigate future earnings risk, the Company recorded significant charges totaling $3,553,373 to write down certain assets and to establish appropriate reserves.

4. **Casmyn Corp.** (A company that explores mineral properties and does mineral testing). The results of operations and gain on disposal of the company's VMC metal fabrication unit.

5. **Mable Co.** The retroactive effect of a change in accounting for interest costs to one of capitalization from one of expensing interest as incurred.