Chapter 4

Income Statement

The income statement is often considered to be the most important financial statement. Frequently used titles for this statement include statement of operations, statement of income, and statement of earnings. Both the statement of operations and statement of income are very popular titles.[1]

Basic Elements of the Income Statement

An income statement summarizes revenues and expenses and gains and losses, and ends with the net income for a specific period. A multiple-step income statement usually presents separately the gross profit, operating income, income before income taxes, and net income.

A simplified multiple-step income statement might look as follows:

	Net Sales (Revenues)	$XXX
–	*Cost of Goods Sold (cost of sales)*	XXX
	Gross Profit	XXX
–	*Operating Expenses (selling and administrative)*	XXX
	Operating Income	XXX
+(–)	*Other Income or Expense*	XXX
	Income Before Income Taxes	XXX
–	*Income Taxes*	XXX
	Net Income	$XXX
	Earnings per Share	$XXX

Some firms use a single-step income statement, which totals revenues and gains (sales, other income, etc.) and then deducts total expenses and losses (cost of goods sold, operating expenses, other expenses, etc.). A simplified single-step income statement might look as follows:

Revenue:	
Net Sales	$XXX
Other Income	XXX
Total Revenue	XXX

Expenses:	
Cost of Goods Sold (cost of sales)	XXX
Operating Expenses (selling and administrative)	XXX
Other Expense	XXX
Income Tax Expense	XXX
Total Expenses	XXX
Net Income	$XXX
Earnings per Share	$XXX

A single-step income statement lists all revenues and gains (usually in order of amount), then lists all expenses and losses (usually in order of amount). Total expense and loss items deducted from total revenue and gain items determine the net income. Most firms that present a single-step income statement modify it in some way, such as presenting federal income tax expense as a separate item.

Exhibits 4-1 and 4-2 illustrate the different types of income statements. In Exhibit 4-1, Blair Corporation uses a single-step income statement, while in Exhibit 4-2, Sun Hydraulics® Corporation uses a multiple-step format.

Exhibit 4-1 BLAIR CORPORATION*

Single-Step Income Statement

Blair Corporation and Subsidiaries
Consolidated Statements of Income

	Years Ended December 31,		
	2006	**2005**	**2004**
Net sales	$426,425,708	$456,625,397	$496,120,207
Other revenue	6,849,913	36,072,657	44,714,912
	433,275,621	492,698,054	540,835,119
Cost and expenses:			
Cost of goods sold	190,831,333	204,121,644	234,972,079
Advertising	126,119,487	119,321,916	128,324,650
General and administrative	116,901,838	135,588,219	131,408,753
Provision for doubtful accounts	687,399	11,669,552	22,664,048
Gain on sale of receivables	—	(27,747,513)	—
Interest (income) expense, net	(1,292,447)	568,466	(122,757)
Other expense, net	477,801	46,833	221,699
	433,725,411	443,569,117	517,468,472
(Loss) income before income taxes	(449,790)	49,128,937	23,366,647
Income tax (benefit) provision	(666,000)	17,583,000	8,498,000
Net income	$ 216,210	$ 31,545,937	$ 14,868,647
Basic earnings per share based on weighted average shares outstanding	$ 0.06	$ 4.79	$ 1.83
Diluted earnings per share based on weighted average shares outstanding and assumed conversions	$ 0.06	$ 4.71	$ 1.80

*"The Company's business consists of the sale of fashion apparel for men and women, plus a wide range of home products." 10-K

For firms that have cost of goods sold, cost of goods manufactured, or cost of services, a multiple-step income statement should be used for analysis. The multiple-step provides intermediate profit figures useful in analysis. You may need to construct the multiple-step format from the single-step.

Exhibit 4-3 (page 148) contains a comprehensive multiple-step income statement illustration. This illustration resembles the vast majority of income statements as presented in the United States. Be familiar with this illustration. It serves as a guide to much of our analysis.

Exhibit 4-2 SUN HYDRAULICS® CORPORATION*

Multiple-Step Income Statement

Sun Hydraulics Corporation
Consolidated Statements of Operations
(In thousands, except per share data)

	For the Year Ended		
	December 30, 2006	December 31, 2005	December 25, 2004
Net sales	$142,282	$116,757	$94,503
Cost of sales	98,350	79,839	65,968
Gross profit	43,932	36,918	28,535
Selling, engineering and administrative expenses	18,881	17,738	16,241
Operating income	25,051	19,180	12,294
Interest expense	312	441	527
Foreign currency transaction (gain) loss	187	(362)	0
Miscellaneous (income) expense	(351)	(36)	35
Income before income taxes	24,903	19,137	11,732
Income tax provision	8,680	6,329	3,902
Net income	$ 16,223	$ 12,808	$ 7,830
Basic net income per common share	$ 1.49	$ 1.18	$ 0.76
Weighted average basic shares outstanding	10,878	10,827	10,269
Diluted net income per common share	$ 1.48	$ 1.17	$ 0.76
Weighted average diluted shares outstanding	10,939	10,918	10,346
Dividends declared per share	$ 0.400	$ 0.300	$ 0.143

*"The Company is a leading designer and manufacturer of high-performance screw-in hydraulic cartridge valves and manifolds, which control force, speed, and motion as integral components in fluid power systems." 10-K

Net Sales (Revenues)

Sales (revenues) represent revenue from goods or services sold to customers. The firm earns revenue from the sale of its principal products. Sales are usually shown net of any discounts, returns, and allowances.

Cost of Goods Sold (Cost of Sales)

This category shows the cost of goods sold to produce revenue. For a retailing firm, the cost of goods sold equals beginning inventory plus purchases minus ending inventory. In a manufacturing firm, the cost of goods manufactured replaces purchases since the goods are produced rather than purchased. A service firm will not have cost of goods sold or cost of sales, but it will often have cost of services.

Other Operating Revenue

Depending on the operations of the business, there may be other operating revenue, such as lease revenue and royalties.

Operating Expenses

Operating expenses consist of two types: selling and administrative. **Selling expenses**, resulting from the company's effort to create sales, include advertising, sales commissions, sales supplies used, and so on. **Administrative expenses** relate to the general administration of the company's operation. They include office salaries, insurance, telephone, bad debt expense, and other costs difficult to allocate.

Exhibit 4-3 ILLUSTRATION OF SPECIAL ITEMS

G AND F COMPANY
Income Statement (Multiple-Step Format)
For the Year Ended December 31, 2007

	Net sales		$ XXX
	Cost of products sold (cost of sales)		(XXX)
	Gross profit		XXX
	Other operating revenue		XXX
	Operating expenses:		
	Selling expenses	$ XXX	
	General expenses	XXX	(XXX)
	Operating income		XXX
	Other income (includes interest income)		XXX
	Other expenses (includes interest expense)		(XXX)
[A]	Unusual or infrequent item disclosed separately [loss]		(XXX)
[B]	Equity in earnings of nonconsolidated subsidiaries [loss]		XXX
	Income before taxes		XXX
	Income taxes related to operations		(XXX)
	Net income from operations		XXX
[C]	Discontinued operations:		
	Income [loss] from operations of discontinued segment (less applicable income taxes of $XXX)	$(XXX)	
	Income [loss] on disposal of division X (less applicable income taxes of $XXX)	(XXX)	(XXX)
[D]	Extraordinary gain [loss] (less applicable income taxes of $XXX)		(XXX)
[E]	Cumulative effect of change in accounting principle [loss] (less applicable income taxes of $XXX)		XXX
	Net income before minority interest		$ XXX
[F]	Minority share of earnings (income) loss		(XXX)
	Net income		$ XXX
	Earnings per share		$ XXX

Other Income or Expense

In this category are secondary activities of the firm, not directly related to the operations. For example, if a manufacturing firm has a warehouse rented, this lease income would be other income. Dividend and interest income and gains and losses from the sale of assets are also included here. Interest expense is categorized as other expense.

Special Income Statement Items

To comprehend and analyze profits, you need to understand income statement items that require special disclosure. Exhibit 4-3 contains items that require special disclosure. These items are lettered to identify them for discussion. Note that some of these items are presented before tax and some are presented net of tax.

(A) Unusual or Infrequent Item Disclosed Separately

Certain income statement items are either unusual or occur infrequently. They might include such items as a gain on sale of securities, write-downs of receivables, or write-downs of inventory. These items are shown with normal, recurring revenues and expenses, and gains and losses. If material, they will be disclosed separately, before tax. Unusual or infrequent items are typically left in primary analysis because they relate to operations.

In supplementary analysis, unusual or infrequent items should be removed net after tax. Usually, an estimate of the tax effect will be necessary. A reasonable estimate of the tax effect can be made by using the effective income tax rate, usually disclosed in a note, or by dividing income taxes by income before taxes.

Refer to Exhibit 4-4, which illustrates an unusual or infrequent item disclosed separately for Taser International, Inc. The unusual or infrequent item was a shareholder litigation expense.

The unusual or infrequent item in 2006 would be removed as follows:

Shareholder litigation settlement expense	$17,650,000
Less estimated tax effect (17.98% × $17,650,000)	3,173,470
Net expense of litigation settlement	$14,476,530

Taser International reported a net loss of $4,087,679 in 2006. Removing the unusual or infrequent item results in a gain of $10,388,851.

Exhibit 4-4 TASER INTERNATIONAL, INC.*

Unusual or Infrequent Item

TASER INTERNATIONAL, INC.
STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2006	2005	2004
		(As restated)	
Net sales	$16,717,851	$47,694,181	$67,639,879
Cost of products sold:			
Direct manufacturing expense	18,296,039	12,843,816	16,898,559
Indirect manufacturing expense (1)	6,242,751	5,252,470	5,556,937
Total cost of products sold	24,538,790	18,096,286	22,455,496
Gross margin	43,179,061	29,597,895	45,184,383
Sales, general and administrative expenses (1)	29,680,764	26,483,485	13,880,322
Research and development expenses (1)	2,704,521	1,574,048	823,593
Shareholder litigation settlement expense	17,650,000	—	—
Income (loss) from operations	(6,856,224)	1,540,362	30,480,468
Interest income	1,880,407	1,229,044	439,450
Interest expense	(7,281)	(4,208)	(1,485)
Other income (expense), net	(481)	(59,772)	2,309
Income (loss) before provision for income taxes	(4,983,579)	2,705,426	30,920,742
Provision (benefit) for income taxes	(895,900)	1,648,910	12,039,000
Net income (loss)	$ (4,087,679)	$ 1,056,516	$18,881,742
Income (loss) per common and common equivalent shares			
Basic	$ (0.07)	$ 0.02	$ 0.33
Diluted	$ (0.07)	$ 0.02	$ 0.30
Weighted average number of common and common equivalent shares outstanding			
Basic	61,984,240	61,303,939	57,232,329
Diluted	61,984,240	63,556,246	62,319,590
(1) Stock-based compensation was allocated as follows:			
Indirect manufacturing expense	$ 131,086	$ —	$ —
Sales, general and administrative	808,341	—	—
Research and development expenses	199,418	—	—
	$ 1,138,845	$ —	$ —

*"Taser International, Inc. . . . is a global leader in the development and manufacture of advanced electronic control devices designed for use in law enforcement." 10-K

(B) Equity in Earnings of Nonconsolidated Subsidiaries

When a firm accounts for its investments in stocks using the equity method (the investment is not consolidated), the investor reports equity earnings (losses). **Equity earnings** (losses) are the investor's proportionate share of the investee's earnings (losses). If the investor owns 20% of the stock of the investee, for example, and the investee reports income of $100,000, then the investor reports $20,000 on its income statement. In this book, the term "equity earnings" will be used unless equity losses are specifically intended.

To the extent that equity earnings are not accompanied by cash dividends, the investor reports earnings greater than the cash flow from the investment. If an investor company reports material equity earnings, its net income could be much greater than its ability to pay dividends or cover maturing liabilities.

For purposes of analysis, the equity in the net income of nonconsolidated subsidiaries raises practical problems. For example, the equity earnings represent earnings of other companies, not earnings from the operations of the business. Thus, equity earnings can distort the reported results of a business's operations. For each ratio influenced by equity earnings, this book suggests a recommended approach described when the ratio is introduced.

Refer to Exhibit 4-5, which illustrates equity in earnings of nonconsolidated subsidiaries for Hormel Foods. Leaving these accounts in the statements presents a problem for profitability analysis because most of the profitability measures relate income figures to other figures (usually balance sheet figures). Because these earnings are from nonconsolidated subsidiaries, an inconsistency can result between the numerator and the denominator when computing a ratio. (Chapter 5 presents a detailed discussion of ratios.)

Exhibit 4-5 HORMEL FOODS*

Equity Income

Consolidated Statements of Operations

(In thousands, except per share amounts)	Fiscal Year Ended October 29, 2006	October 30, 2005	October 30, 2004
Net sales	**$5,745,481**	$5,413,997	$4,779,875
Cost of products sold	**4,362,291**	4,129,549	3,655,837
Gross Profit	**1,383,190**	1,284,448	1,124,038
Expenses:			
Selling and delivery	**754,143**	691,792	621,694
Administrative and general	**182,891**	172,242	146,488
Gain on sale of business	**0**	0	(18,063)
Total Expenses and Gain on Sale of Business	**937,034**	864,034	750,119
Equity in earnings of affiliates	**4,553**	5,525	6,458
Operating Income	**450,709**	425,939	380,377
Other income and expense:			
Interest and investment income	**5,470**	8,531	14,363
Interest expense	**(25,636)**	(27,744)	(27,142)
Earnings Before Income Taxes	**430,543**	406,726	367,598
Provision for income taxes	**144,404**	152,123	134,048
Net Earnings	**$ 286,139**	$ 254,603	$ 233,550
Net Earnings Per Share:			
Basic	**$ 2.08**	$ 1.84	$ 1.69
Diluted	**$ 2.05**	$ 1.82	$ 1.67
Weighted Average Shares Outstanding:			
Basic	**137,845**	138,040	138,596
Diluted	**139,561**	139,577	140,179

*"The Company started as a processor of meat and food products and continues in this line of business." 10-K

Some ratios are distorted more than others by equity earnings. For example, the ratio that relates income to sales can be distorted because of equity earnings. The numerator of the ratio includes the earnings of the operating company and the equity earnings of nonconsolidated subsidiaries. The denominator (sales) includes only the sales of the operating company. The sales of the unconsolidated subsidiaries will not appear on the investor's income statement because the subsidiary was not consolidated. This causes the ratio to be distorted.

Equity in earnings of nonconsolidated subsidiaries (equity earnings) will be presented before tax. Any tax will be related to the dividend received, and it will typically be immaterial. When removing equity earnings for analysis, do not attempt a tax computation.

Income Taxes Related to Operations

Federal, state, and local income taxes, based on reported accounting profit, are shown here. Income tax expense includes taxes paid and taxes deferred. Income taxes reported here will not include taxes on items presented net of tax.

(C) Discontinued Operations

A common type of unusual item is the disposal of a business or product line. If the disposal meets the criteria of a discontinued operation, then a separate income statement category for the gain or loss from disposal of a segment of the business must be provided. In addition, the results of operations of the segment that has been or will be disposed of are reported in conjunction with the gain or loss on disposal. These effects appear as a separate category after continuing operations.

Discontinued operations pose a problem for profitability analysis. Ideally, income from continuing operations would be the better figure to use to project future income. Several practical problems associated with the removal of a gain or loss from the discontinued operations occur in the primary profitability analysis. These problems revolve around two points: (1) an inadequate disclosure of data related to the discontinued operations, in order to remove the balance sheet amounts associated with the discontinued operations; and (2) the lack of past profit and loss data associated with the discontinued operations.

Exhibit 4-6 illustrates the presentation of discontinued operations in net income. The best analysis would remove the income statement items that relate to the discontinued operations.

The income statement items that relate to a discontinued operation are always presented net of applicable income taxes. Therefore, the items as presented on the income statement can be removed for primary analysis without further adjustment for income taxes. Supplementary analysis considers discontinued operations in order to avoid disregarding these items.

Ideally, the balance sheet accounts that relate to the discontinued operations should be removed for primary analysis. Consider these items on a supplemental basis because they will not contribute to future operating revenue. However, inadequate disclosure often makes it impossible to remove these items from your analysis.

The balance sheet items related to discontinued operations are frequently disposed of when the business or product line has been disposed of prior to the year-end balance sheet date. In this case, the balance sheet accounts related to discontinued operations do not present a problem for the current year.

(D) Extraordinary Items

Extraordinary items are material events and transactions distinguished by their unusual nature and by the infrequency of their occurrence. Examples include a major casualty (such as a fire), prohibition under a newly enacted law, or an expropriation. These items, net of their tax effects, must be shown separately. Some pronouncements have specified items that must be considered extraordinary; an example is a material tax loss carryover. The effect of an extraordinary item on earnings per share must also be shown separately. Exhibit 4-7 presents an extraordinary gain.

In analysis of income for purposes of determining a trend, extraordinary items should be eliminated since the extraordinary item is not expected to recur. In supplementary analysis, these extraordinary items should be considered, as this approach avoids disregarding these items.

Extraordinary items are always presented net of applicable income taxes. Therefore, the items as presented on the income statement are removed without further adjustment for income taxes.

Exhibit 4-6 CROWN HOLDINGS, INC.*

Discontinued Operations

CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share amounts)

For the years ended December 31	2006	2005	2004
Net sales	$6,982	$6,675	$6,285
Cost of products sold, excluding depreciation and amortization	5,863	5,535	5,244
Depreciation and amortization	227	237	247
Gross profit	892	903	794
Selling and administrative expense	316	339	307
Provision for asbestos	10	10	35
Provision for restructuring	15	13	6
Provision for asset impairments and loss/gain on sale of assets	(64)	(18)	31
Loss from early extinguishments of debt		383	39
Interest expense	286	361	361
Interest income	(12)	(9)	(8)
Translation and exchange adjustments	6	94	(98)
Income/(loss) from continuing operations before income taxes, minority interests and equity earnings	335	(270)	121
Provision/(benefit) for income taxes	(62)	11	67
Minority interests	(55)	(51)	(41)
Equity earnings		12	14
Income/(loss) from continuing operations	342	(320)	27
Discontinued operations			
Income/(loss) before income taxes	(34)	(21)	40
Provision/(benefit) for income taxes	(1)	21	16
Income/(loss) from discontinued operations	(33)	(42)	24
Net income/(loss)	$ 309	$ (362)	$ 51
Per common share data:			
Earnings/(loss)			
Basic—Continuing operations	$ 2.07	$ (1.93)	$ 0.16
—Discontinued operations	(0.20)	(0.25)	(0.15)
	$ 1.87	$ (2.18)	$ 0.31
Diluted—Continuing operations	$ 2.01	$ (1.93)	$ 0.16
—Discontinued operations	(0.19)	(0.25)	0.14
	$ 1.82	$ (2.18)	$ 0.30

*"The Company is a worldwide leader in the design, manufacture and sale of packaging products for consumer goods." 10-K

(E) Cumulative Effect of Change in Accounting Principle

There are two possible methods to disclose a change in accounting principle. These are the retrospective application and the prospective application.

With the retrospective application, the accounts of each prior period are adjusted to reflect the effects of applying the new accounting principle. The new accounting principle is used in the current financial statements.

With the prospective application, the accounts of each prior period are *not* adjusted to reflect the effects of applying the new accounting principle. The new accounting principle is used in the current financial statements, and the income effect of using the new principle in prior financial statements is disclosed on the current income statement as a cumulative effect of change in accounting principle, net of tax. This presents a comparability problem between accounting periods.

A change from one generally accepted principle to another can be the result of a voluntary change in accounting principle, or a mandatory change because the FASB has adopted a new principle.

Exhibit 4-7 BRIGGS & STRATTON CORPORATION*

Extraordinary Item

BRIGGS & STRATTON CORPORATION
Consolidated Statements of Earnings

FOR THE FISCAL YEARS ENDED JULY 2, 2006, JULY 3, 2005 AND JUNE 27, 2004

(In thousands, except per share data)	2006	2005	2004
NET SALES	$2,542,171	$2,654,875	$1,947,364
Cost of Goods Sold	2,050,487	2,149,984	1,507,492
Gross Profit	491,684	504,891	439,872
ENGINEERING, SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	315,718	314,123	205,663
Income from Operations	175,966	190,768	234,209
INTEREST EXPENSE	(42,091)	(36,883)	(37,665)
OTHER INCOME, Net	18,491	20,430	8,460
Income Before Provision for Income Taxes	152,366	174,315	205,004
PROVISION FOR INCOME TAXES	50,020	57,548	68,890
Income Before Extraordinary Item	102,346	116,767	136,114
EXTRAORDINARY GAIN—NEGATIVE GOODWILL	—	19,800	—
NET INCOME	$ 102,346	$ 136,567	$ 136,114
EARNINGS PER SHARE DATA*			
Weighted Average Shares Outstanding	51,479	51,472	45,286
Income Before Extraordinary Item	$ 1.99	$ 2.27	$ 3.01
Extraordinary Gain	—	.38	—
Basic Earnings Per Share	$ 1.99	$ 2.65	$ 3.01
Diluted Average Shares Outstanding	51,594	51,954	50,680
Income Before Extraordinary Item	$ 1.98	$ 2.25	$ 2.77
Extraordinary Gain	—	.38	—
Diluted Earnings Per Share	$ 1.98	$ 2.63	$ 2.77

*Share data adjusted for effect of 2-for-1 stock split effective October 29, 2004.

*"Briggs & Stratton is the world's largest producer of air-cooled gasoline engines for outdoor power equipment." 10-K

An FASB standard issued in May 2005 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. This standard does not rule out the possibility that a new accounting pronouncement could include specific directions on how to report a change in principle.

Prior to the 2005 standard, voluntary changes in accounting principle were presented using the prospective method in the United States. This was inconsistent with the reporting under the International Accounting Standards Board (IASB). Reporting of a voluntary change in accounting principle was identified as an area in which financial reporting in the United States could be improved by eliminating the differences between the United States and the IASB. The new standard for reporting a voluntary change in accounting principle was effective for changes in fiscal years beginning after December 15, 2005.

A review of 2006 annual reports revealed that a cumulative effect of change in accounting principle was present in the 2006, 2005, and 2004 columns of the statement of income. Exhibit 4-8 illustrates a cumulative effect of change in accounting principle.

Because of the new standard, it is reasonable to expect the number of companies reporting a cumulative effect of change in accounting principle to be substantially reduced. When it is present, it will still be important to know how to treat this item when doing analysis.

(F) Minority Share of Earnings

If a firm consolidates subsidiaries not wholly owned, the total revenues and expenses of the subsidiaries are included with those of the parent. However, to determine the income that would accrue to the parent, it is necessary to deduct the portion of income that would belong

Exhibit 4-8 ZEBRA DESIGNS*

Cumulative Effect of Change in Accounting Principle

ZEBRA TECHNOLOGIES CORPORATION
Consolidated Statements of Earnings (in Part)
(In thousands, except per share data)

	Year Ended December 31,		
	2006	2005 (restated see Note 2)	2004 (restated see Note 2)
Net sales	$759,524	$702,271	$663,054
Cost of sales	401,104	348,851	320,951
Gross profit	358,420	353,420	342,103
Operating expenses:			
Selling and marketing	96,788	91,630	79,111
Research and development	48,959	47,359	38,609
General and administrative	62,656	64,050	53,083
Amortization of intangible assets	3,653	2,341	2,569
Litigation settlement	53,392	—	—
Insurance receivable reserve	12,543	—	—
Acquired in-process technology	—	—	22
Exit costs	—	2,012	2,100
Total operating expenses	277,991	207,392	175,494
Operating income	80,429	146,028	166,609
Other income (expense):			
Investment income	23,182	13,417	10,628
Interest expense	(252)	(79)	(44)
Foreign exchange gain (loss)	(635)	1,286	485
Other, net	(1,082)	(370)	(1,594)
Total other income	21,213	14,254	9,475
Income before income taxes and cumulative effect of accounting change	101,642	160,282	176,084
Income taxes	32,015	54,098	60,943
Income before cumulative effect of accounting change	69,627	106,184	115,141
Cumulative effect of accounting change, net of income taxes of $694 (See Note 2)	1,319	—	—
Net income	$ 70,946	$106,184	$115,141

Notes to Consolidated Financial Statements (in Part)

Note 2 Summary of Significant Accounting Policies (in Part)

SFAS No. 123(R) requires entities to estimate the number of forfeitures expected to occur and record expense based upon the number of awards expected to vest. Prior to the adoption of SFAS No. 123(R), Zebra accounted for forfeitures as they occurred as permitted under previous accounting standards. The requirement to estimate forfeitures is classified as an accounting change under APB Opinion No. 20, Accounting Changes, which requires a one-time adjustment in the period of adoption. The one-time adjustment (cumulative effect of accounting change) related to the change in estimating forfeitures increased income by $1,319,000, net of applicable taxes, for the year ended December 31, 2006.

*"Zebra Technologies Corporation and its wholly-owned subsidiaries (Zebra) design, manufacture, sell and support a broad range of direct thermal and thermal transfer label printers, radio frequency identification printer/encoders, dye sublimation card printers, digital photo printers and related accessories and support software." 10-K

to the minority owners. This is labeled "minority share of earnings" or "minority interest." Note that this item sometimes appears before and sometimes after the tax provision on the income statement. When presented before the tax provision, it is usually presented gross of tax. When presented after the tax provision, it is presented net of tax. In this book, assume net-of-tax treatment. Exhibit 4-9 illustrates minority share of earnings.

Some ratios can be materially distorted because of a minority share of earnings. For each ratio influenced by a minority share of earnings, this book suggests a recommended approach.

Earnings per Share

In general, **earnings per share** is earnings divided by the number of shares of outstanding common stock. Chapter 9 presents earnings per share in detail and explains its computation. Meanwhile, use the formula of net income divided by outstanding shares of common stock.

Retained Earnings

Retained Earnings, an account on the balance sheet, represents the undistributed earnings of the corporation. A reconciliation of retained earnings summarizes the changes in retained earnings. It shows the retained earnings at the beginning of the year, the net income for the year as an addition, the dividends as a subtraction, and concludes with end-of-year retained earnings. It also includes, if appropriate, prior period adjustments (net of tax) and some adjustments for changes in accounting principles (net of tax). These restate beginning retained earnings. Other possible changes to retained earnings are beyond the scope of this book.

Sometimes a portion of retained earnings may be unavailable for dividends because it has been appropriated (restricted). Appropriated retained earnings remain part of retained earnings. The appropriation of retained earnings may or may not have significance.

Appropriations that result from legal requirements (usually state law) and appropriations that result from contractual agreements are potentially significant. They may leave unappropriated retained earnings inadequate to pay dividends. (*Note:* A corporation will not be able to pay a cash dividend even with an adequate unrestricted balance in retained earnings unless it has adequate cash or ability to raise cash and has complied with the state law where it is incorporated.)

Most appropriations result from management decisions. These are usually not significant because management can choose to remove the appropriation.

Caution should be exercised not to confuse retained earnings or appropriated retained earnings with cash or any other asset. There is no cash or any other asset in retained earnings. The reason for an appropriation will be disclosed either in the reconciliation of retained earnings or in a note. From this disclosure, try to arrive at an opinion as to the significance, if any.

The reconciliation of retained earnings usually appears as part of a statement of stockholders' equity. Sometimes it is combined with the income statement. Exhibit 4-10 gives an example of a reconciliation of retained earnings being presented with a stockholders' equity statement.

Dividends and Stock Splits

Dividends return profits to the owners of a corporation. A cash dividend declared by the Board of Directors reduces retained earnings by the amount of the dividends declared and creates the current liability, dividends payable. The date of payment occurs after the date of declaration. The dividend payment eliminates the liability, dividends payable, and reduces cash. Note that the date of the declaration of dividends, not the date of the dividend payment, affects retained earnings and creates the liability.

The Board of Directors may elect to declare and issue another type of dividend, termed a *stock dividend*. The firm issues a percentage of outstanding stock as new shares to existing shareholders. If the Board declares a 10% stock dividend, for example, an owner holding 1,000 shares would receive an additional 100 shares of new stock. The accounting for a stock dividend, assuming a relatively small distribution (less than 25% of the existing stock), requires removing the fair market value of the stock at the date of declaration from retained earnings and transferring it to paid-in capital. With a material stock dividend, the amount removed from retained earnings and transferred to paid-in capital is determined by

Exhibit 4-9 NEWMONT MINING CORPORATION*

Minority Interest

STATEMENTS OF CONSOLIDATED INCOME

	2006	2005	2004
	Years Ended December 31, (In millions, except per share data)		
Revenues			
Sales—gold, net	$4,316	$3,680	$3,540
Sales—copper, net	671	672	786
	4,987	4,352	4,326
Cost and expenses			
Costs applicable to sales (exclusive of depreciation, depletion and amortization shown separately below)			
Gold	2,207	1,990	1,878
Copper	308	303	305
Depreciation, depletion and amortization	636	635	652
Exploration	170	147	107
Advanced projects, research and development	94	73	80
General and administrative	149	134	116
Write-down of goodwill (Note 18)	—	41	52
Write-down of long-lived assets (Note 4)	3	43	39
Other expense, net (Note 5)	149	112	34
	3,716	3,478	3,263
Other income (expense)			
Other income, net (Note 6)	451	269	102
Interest expense, net of capitalized interest of $57, $39, and $13, respectively	(97)	(97)	(97)
	354	172	5
Income from continuing operations before income tax, minority interest and equity income of affiliates	1,625	1,046	1,068
Income tax expense (Note 7)	(424)	(310)	(324)
Minority interest in income of consolidated subsidiaries	(363)	(380)	(335)
Equity income of affiliates (Note 8)	2	4	2
Income from continuing operations	840	360	411
(Loss) income from discontinued operations (Note 9)	(49)	(38)	79
Cumulative effect of a change in accounting principle, net of tax of $25 in 2004 (Note 3)	—	—	(47)
Net income	$ 791	$ 322	$ 443
Income from continuing operations per common share, basic	$ 1.87	$ 0.81	$ 0.93
(Loss) income from discontinued operations per common share, basic	(0.11)	(0.09)	0.18
Cumulative effect of a change in accounting principle per common share, basic	—	—	(0.11)
Net income per common share, basic (Note 10)	$ 1.76	$ 0.72	$ 1.00
Income from continuing operations per common share, diluted	$ 1.86	$ 0.80	$ 0.92
(Loss) income from discontinued operations per common share, diluted	(0.11)	(0.08)	0.18
Cumulative effect of a change in accounting principle per common share, diluted	—	—	(0.11)
Net income per common share, diluted (Note 10)	$ 1.75	$ 0.72	$ 0.99
Basic weighted-average common shares outstanding	450	446	443
Diluted weighted-average common shares outstanding	452	449	447
Cash dividends declared per common share	$ 0.40	$ 0.40	$ 0.30

*"Newmont Mining Corporation is primarily a gold producer with significant assets or operations in the United States, Australia, Peru, Indonesia, Ghana, Canada, Bolivia, New Zealand, and Mexico." 10-K

Exhibit 4-10 RELIANCE STEEL & ALUMINUM CO.*

Consolidated Statements of Shareholders' Equity

RELIANCE STEEL & ALUMINUM CO.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In thousands, except share and per share amounts)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount			
Balance at January 1, 2004	64,451,744	$303,587	$ 344,962	$ (930)	$ 647,619
Net income for the year	—	—	169,728	—	169,728
Other comprehensive income (loss):					
Foreign currency translation gain	—	—	—	1,476	1,476
Unrealized loss on investments	—	—	—	(166)	(166)
Minimum pension liability	—	—	—	72	72
Comprehensive income					171,110
Stock options exercised	873,600	10,130	1,905	—	12,035
Stock issued under incentive bonus plan	14,590	236	—	—	236
Cash dividends—$.13 per share	—	—	(8,448)	—	(8,448)
Balance at December 31, 2004	65,339,934	313,953	508,147	452	822,552
Net income for the year	—	—	205,437	—	205,437
Other comprehensive income (loss):					
Foreign currency translation gain	—	—	—	1	1
Unrealized gain on investments	—	—	—	40	40
Minimum pension liability	—	—	—	(168)	(168)
Comprehensive income					205,310
Stock options exercised	866,900	10,811	3,476	—	14,287
Stock issued under incentive bonus plan	11,164	246	—	—	246
Cash dividends—$.19 per share	—	—	(12,530)	—	(12,530)
Balance at December 31, 2005	66,217,998	$325,010	$ 704,530	$ 325	$1,029,865
Net income for the year	—	—	354,507	—	354,507
Other comprehensive income (loss):					
Foreign currency translation gain	—	—	—	1,221	1,221
Unrealized gain on investments	—	—	—	116	116
Minimum pension liability	—	—	—	423	423
Comprehensive income					356,267
Adjustment to initially apply SFAS No. 158, net of tax	—	—	—	(3,716)	(3,716)
Stock options exercised	438,290	7,115	3,446	—	10,561
Stock based compensation	—	6,060	—	—	6,060
Stock and stock options issued in connection with business acquisition	8,962,268	360,453	—	—	360,453
Stock issued to a retirement savings plan	78,288	2,830	—	—	2,830
Stock issued under incentive bonus plan	5,202	222	—	—	222
Cash dividends—$22 per share	—	—	(16,144)	—	(16,144)
Balance at December 31, 2006	75,702,046	$701,690	$1,046,339	$(1,631)	$1,746,398

*"We are one of the largest metals service center companies in the United States." 10-K

multiplying the par value of the stock by the number of additional shares. Note that the overall effect of a stock dividend leaves total stockholders' equity and each owner's share of stockholders' equity unchanged. However, the total number of outstanding shares increases.

A stock dividend should reduce the market value of individual shares by the percentage of the stock dividend. Total market value considering all outstanding shares should not change in theory. In practice, the market value change may not be the same percentage as the stock dividend.

A more drastic device to change the market value of individual shares is by declaring a stock split. A 2-for-1 split should reduce the market value per share to one-half the amount prior to the split. The market value per share in practice may not change exactly in proportion to the split. The market value will result from the supply and demand for the stock.

Lowering the market value is sometimes desirable for stocks selling at high prices (as perceived by management). Stocks with high prices are less readily traded. A stock dividend or stock split can influence the demand for the stock.

A stock split merely increases the number of shares of stock. It does not usually change retained earnings or paid-in capital. For example, if a firm had 1,000 shares of common stock, a 2-for-1 stock split would result in 2,000 shares.

For a stock split, the par or stated value of the stock is changed in proportion to the stock split, and no change is made to retained earnings, additional paid-in capital, or capital stock. For example, a firm with $10 par common stock that declares a 2-for-1 stock split would reduce the par value to $5.

Since the number of shares changes under both a stock dividend and stock split, any ratio based on the number of shares must be restated for a meaningful comparison. For example, if a firm had earnings per share of $4 in 2007, a 2-for-1 stock split in 2008 would require restatement of the earnings per share to $2 in 2007 because of the increase in the shares. Restatement will be made for all prior financial statements presented with the current financial statements, including a 5- or 10-year summary.

Legality of Distributions to Stockholders

The legality of distributions to stockholders is governed by applicable state law. Currently, the 50 states may be classified into one of three groups for purposes of distributions to stockholders. These groups are the following:[2]

1. Distributions to stockholders are acceptable as long as the firm has the ability to pay debts as they come due in the normal course of business.
2. Distributions to stockholders are acceptable as long as the firm is solvent and the distributions do not exceed the fair value of net assets.
3. Distributions consist of solvency and balance sheet tests of liquidity and risk.

Thus, the appropriateness of a distribution to stockholders is a legal interpretation. Accountants have not accepted the role of disclosing the firm's capacity to make distributions to stockholders. Accountants have accepted the role of disclosing appropriations (restrictions) of retained earnings. Appropriations can temporarily limit the firm's ability to make distributions. These appropriations are typically directed toward limiting or prohibiting the payment of cash dividends.

During the 1980s and 1990s, there were many distributions to stockholders that exceeded the net book value of the firm's assets. These were often accompanied by debt-financed restructurings. Often, the result was a deficit balance in retained earnings and sometimes a deficit balance in total stockholders' equity.

During 1988, Holiday Corporation (owner of Holiday Inns of America) distributed a $65 per share dividend to prevent a hostile takeover. The result was a substantial deficit to retained earnings and approximately a $770 million deficit to total stockholders' equity.[3]

A similar situation took place at Owens Corning during the 1980s as it made a substantial distribution to stockholders by way of a debt-financed restructuring. Owens Corning also had substantial expenses related to asbestos-related illnesses. At the end of 1995, Owens Corning had a deficit in retained earnings of $781,000,000, and a deficit in total stockholders' equity of $212,000,000.

An Owens Corning news release of June 20, 1996, stated (in Part):

> *The Board of Directors has approved an annual dividend policy of 25 cents per share and declared a quarterly dividend of 6-1/4 cents per share payable on October 15, 1996 to shareholders of record as of September 30, 1996.*
>
> *In reference to the dividend, we were able to initiate this action because debt has been reduced to target levels and cash flow from operations will be in excess of internal funding requirements.*
>
> *We are delighted to be able to reward our shareholders with a dividend. Reinstating the dividend has been a priority of mine since joining the company and I am pleased that we now are in a position to set the date.*

Comprehensive Income

Chapter 1 described the Concept Statements that serve as the basis for evaluating existing standards of financial accounting and reports. Concept Statement Nos. 5 and 6 included the concept of comprehensive income. Comprehensive income was described in SFAC No. 6 as the change in equity of a business enterprise during a period from transactions and other events and circumstances from nonowner sources.

Subsequently, SFAS No. 130 was issued that required the reporting of comprehensive income, but using a narrower definition than in SFAC No. 6. Under SFAS No. 130, comprehensive income is net income plus the period's change in accumulated other comprehensive income. Accumulated other comprehensive income is a category within stockholders' equity, described in Chapter 3.

Categories within accumulated other comprehensive income are:

1. *Foreign currency translation adjustments.* The expansion of international business and extensive currency realignment have created special accounting problems. The biggest difficulty has been related to translating foreign financial statements into the financial statements of a U.S. enterprise.

   U.S. financial reporting calls for postponing the recognition of unrealized exchange gains and losses until the foreign operation is substantially liquidated. This postponement is accomplished by creating a separate category within stockholders' equity to carry unrealized exchange gains and losses. This method eliminates the wide fluctuations in earnings from translation adjustments for most firms. For subsidiaries operating in highly inflationary economies, translation adjustments are charged to net earnings. Also, actual foreign currency exchange gains (losses) are included in net earnings.
2. *Unrealized holding gains and losses on available-for-sale marketable securities.* Debt and equity securities classified as available-for-sale securities are carried at fair value. Unrealized holding gains and losses are included in a separate category within stockholders' equity until realized. Thus, the unrealized holding gains and losses are not included in net earnings. Note that this accounting only applies to securities available for sale. Trading securities are reported at their fair values on the balance sheet date, and unrealized holding gains and losses are included in income of the current period. Debt securities held to maturity are reported at their amortized cost on the balance sheet date.
3. *Changes to stockholders' equity resulting from additional minimum pension liability adjustments.* Accounting standards require a reduction in stockholders' equity for a minimum pension liability under a defined benefit plan. Accounting for a defined benefit plan is reviewed in Chapter 7.
4. *Unrealized gains and losses from derivative instruments.* Derivative instruments are financial instruments or other contracts where rights or obligations meet the definitions of assets or liabilities. The gain or loss for some derivative instruments is reported in current earnings. For other derivative instruments, the gain or loss is reported as a component of other comprehensive income. The gain or loss for these instruments is recognized in subsequent periods in income as the hedged forecasted transactions affect earnings.

   Required disclosures are the following:

   - Comprehensive income
   - Each category of other comprehensive income
   - Reclassification adjustments for categories of other comprehensive income
   - Tax effects for each category of other comprehensive income
   - Balances for each category of accumulated other comprehensive income

The accounting standard provides considerable flexibility in reporting comprehensive income. One format uses a single income statement to report net income and comprehensive income. The second format reports comprehensive income in a separate statement of financial activity. The third format reports comprehensive income within the statement of changes in stockholders' equity. Exhibit 4-11 illustrates the three format options provided for in the accounting standard. Exhibit 4-10 presents the accumulated other comprehensive income (loss) of Reliance Steel & Aluminum Co. Reliance presents this within its consolidated statements of shareholders' equity.

The first two options are not popular because comprehensive income would be closely tied to the income statement. Comprehensive income will typically be more volatile than net

Exhibit 4-11 REPORTING COMPREHENSIVE INCOME

Format A Single Income Statement to Report Net Income and Comprehensive Income

XYZ Corporation
Statement of Income and Comprehensive Income
For the Year Ended December 31, 2008

(Dollars in thousands, except per share)	
Sales	$230,000
Cost of goods sold	140,000
Gross profit	90,000
Operating expenses	40,000
Operating income	50,000
Other income	4,000
Income before income taxes	54,000
Income taxes	20,000
Net income	34,000
Other comprehensive income	
Available-for-sale securities adjustment, net of $2,500 income tax	5,500
Minimum pension liability adjustment, net of $1,000 income tax	3,500
Foreign currency translation adjustment, net of $1,500 income tax benefit	(5,000)
Other comprehensive income	4,000
Comprehensive income	$ 38,000
Earnings per share	
(Earnings per share continue to be calculated based on net income.)	$2.80

Format B Separate Comprehensive Income Statement

XYZ Corporation
Statement of Comprehensive Income
For the Year Ended December 31, 2008

(Dollars in thousands)		
Net income		$34,000
Other comprehensive income		
Available-for-sale securities adjustment, net of $2,500 income tax	$5,500	
Minimum pension liability adjustment, net of $1,000 income tax	3,500	
Foreign currency translation adjustments, net of $1,500 income tax benefit	(5,000)	
Total other comprehensive income		4,000
Comprehensive income		$38,000

Format C Comprehensive Income Presented with Statement of Changes in Stockholders' Equity

XYZ Corporation
Statement of Stockholders' Equity for the Year Ended December 31, 2008

				Common Stock	
(Dollars in thousands)	**Total**	**Retained Earnings**	**Accumulated Other Comprehensive Income**	**Amount**	**Shares**
Beginning balance	$180,000	$60,000	$10,000	$110,000	55,000
Net income	34,000	34,000			
Other comprehensive income:					
Available-for-sale securities adjustment, net of $2,500 income tax	5,500		5,500		
Minimum pension liability adjustment, net of $1,000 income tax	3,500		3,500		
Foreign currency translation adjustment, net of $1,500 income tax benefit	(5,000)		(5,000)		
Comprehensive income	38,000				
Ending balance	$218,000	$94,000	$14,000	$110,000	55,000

income. This is because the items within accumulated other comprehensive income have the potential to be volatile. A good case could be made that comprehensive income is a better indication of long-run profitability than is net income. Some firms have elected to disclose comprehensive income as a note to the financial statements. The coverage of comprehensive income in analysis is in Chapter 12.

Summary

The income statement summarizes the profit for a specific period of time. To understand and analyze profitability, the reader must be familiar with the components of income, as well as income statement items that require special disclosure. This chapter presented special income statement items, such as unusual or infrequent items disclosed separately, equity in earnings of nonconsolidated subsidiaries, discontinued operations, extraordinary items, and minority shares of earnings. This chapter also covered the reconciliation of retained earnings, dividends and stock splits, and comprehensive income.

to the net

1. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "KB Home" (or under Ticker Symbol, enter "KBH"). Select the 10-K filed February 13, 2007.
   a. What is the amount of minority interests for 2007?
   b. What is the amount of equity earnings for 2007? Describe equity earnings.
2. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "Amazoncom Inc" (or under Ticker Symbol, enter "AMZN"). Select the 10-K filed February 16, 2007.
   a. What were the net sales for 2006, 2005, and 2004?
   b. What were the gross profits for 2006, 2005, and 2004?
   c. What were the income from operations for 2006, 2005, and 2004?
   d. What were the interest expenses for 2006, 2005, and 2004?
   e. Comment considering the data in (a), (b), (c), and (d).
3. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "Alexander & Baldwin, Inc." (or under Ticker Symbol, enter "ALEX"). Select the 10-K filed February 26, 2007.
   a. Describe the account Equity in Income of Real Estate Affiliates.
   b. For 2006, would you describe Income from Discontinued Operations Net of Income Taxes to be material?
   c. For 2005, identify an unusual or infrequent item.
   d. What is the major operating revenue?
   e. What are the major operating costs and expenses?
4. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "Kroger Co" (or under Ticker Symbol, enter "KR"). Select the 10-K filed April 4, 2007.
   a. Why is the goodwill account on the balance sheet?
   b. Why is the goodwill impairment charge on the consolidated statements of earnings for 2004? (Review Note 2—Goodwill.)
   c. Why is the goodwill impairment charge described as a noncash impairment?
5. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers."

   This exercise will view the presentation format of three firms as to how they present comprehensive income.

   Firm #1—Occidental Petroleum Corporation

   Under Company Name, enter "Occidental Petroleum" (or under Ticker Symbol, enter "OXY"). Select the 10-K filed February 27, 2007.

   a. Indicate the format presentation selected by Occidental Petroleum Corporation.

   Firm #2—El Paso Corporation

   Under Company Name, enter "El Paso Corporation" (or under Ticker Symbol, enter "EI"). Select the 10-K filed February 28, 2007.

b. Indicate the format presentation selected by El Paso Corporation.

Firm #3—Arden Group, Inc.

Under Company Name, enter "Arden Group Inc." (or under Ticker Symbol, enter "ARDNA"). Select the 10-K filed April 16, 2007.

c. Indicate the format presentation selected by Arden Group Inc.

In your opinion, which of the three alternative format presentations is the best for the user of the statement?

6. Go to http://www.iasplus.com/fs/fs.htm. Click on "IFRS Model Financial Statements." Use the most recent year presented.
   a. Review the consolidated income statement, expenses analyzed by function. Comment on similarities and differences to the U.S. GAAP income statement.
   b. Review the consolidated income statement, expenses analyzed by nature. Comment on similarities and difference to the U.S. GAAP income statement.

Questions

Q 4-1. What are extraordinary items? How are they shown on the income statement? Why are they shown in that manner?

Q 4-2. Which of the following would be classified as extraordinary?
- a. Selling expense
- b. Interest expense
- c. Gain on the sale of marketable securities
- d. Loss from flood
- e. Income tax expense
- f. Loss from prohibition of red dye
- g. Loss from the write-down of inventory

Q 4-3. Give three examples of unusual or infrequent items that are disclosed separately. Why are they shown separately? Are they presented before or after tax? Why or why not?

Q 4-4. Why is the equity in earnings of nonconsolidated subsidiaries sometimes a problem in profitability analysis? Discuss with respect to income versus cash flow.

Q 4-5. A health food distributor selling wholesale dairy products and vitamins decides to discontinue the division that sells vitamins. How should this discontinuance be classified on the income statement?

Q 4-6. Why are unusual or infrequent items disclosed before tax?

Q 4-7. In the future, we should expect few presentations of a "cumulative effect of change in accounting principle." Comment.

Q 4-8. How does the declaration of a cash dividend affect the financial statements? How does the payment of a cash dividend affect the financial statements?

Q 4-9. What is the difference in the impact on financial statements of a stock dividend versus a stock split?

Q 4-10. Why is minority share of earnings deducted before arriving at net income?

Q 4-11. Explain the relationship between the income statement and the reconciliation of retained earnings.

Q 4-12. List the three types of appropriated retained earnings accounts. Which of these types is most likely not a detriment to the payment of a dividend? Explain.

Q 4-13. A balance sheet represents a specific date, such as "December 31," while an income statement covers a period of time, such as "For the Year Ended December 31, 2008." Why does this difference exist?

Q 4-14. Describe the following items:
a. Minority share of earnings
b. Equity in earnings of nonconsolidated subsidiaries

Q 4-15. An income statement is a summary of revenues and expenses and gains and losses, ending with net income for a specific period of time. Indicate the two traditional formats for presenting the income statement. Which of these formats is preferable for analysis? Why?

Q 4-16. Melcher Company reported earnings per share in 2008 and 2007 of $2.00 and $1.60, respectively. In 2009, there was a 2-for-1 stock split, and the earnings per share for 2009 were reported to be $1.40. Give a three-year presentation of earnings per share (2007–2009).

Q 4-17. Comment on your ability to determine a firm's capacity to make distributions to stockholders, using published financial statements.

Q 4-18. Management does not usually like to tie comprehensive income closely with the income statement. Comment.

Problems

P 4-1. The following information for Decher Automotives covers the year ended 2008:

Administrative expense	$ 62,000
Dividend income	10,000
Income taxes	100,000
Interest expense	20,000
Merchandise inventory, 1/1	650,000
Merchandise inventory, 12/31	440,000
Flood loss (net of tax)	30,000
Purchases	460,000
Sales	1,000,000
Selling expenses	43,000

Required
a. Prepare a multiple-step income statement.
b. Assuming that 100,000 shares of common stock are outstanding, calculate the earnings per share before extraordinary items and the net earnings per share.
c. Prepare a single-step income statement.

P 4-2. The following information for Lesky Corporation covers the year ended December 31, 2008:

LESKY CORPORATION
Income Statement
For the Year Ended December 31, 2008

Revenue:		
Revenues from sales		$362,000
Rental income		1,000
Interest		2,400
Total revenue		365,400
Expenses:		
Cost of products sold	$242,000	
Selling expenses	47,000	
Administrative and general expenses	11,400	
Interest expense	2,200	
Federal and state income taxes	20,300	
Total expenses		322,900
Net income		$ 42,500

Required
Change this statement to a multiple-step format, as illustrated in this chapter.

P 4-3. The accounts of Consolidated Can contain the following amounts at December 31, 2008:

Cost of products sold	$410,000
Dividends	3,000
Extraordinary gain (net of tax)	1,000
Income taxes	9,300
Interest expense	8,700
Other income	1,600
Retained earnings, 1/1	270,000
Sales	480,000
Selling and administrative expense	42,000

Required Prepare a multiple-step income statement combined with a reconciliation of retained earnings for the year ended December 31, 2008.

P 4-4. The following items are from Taperline Corporation on December 31, 2008. Assume a flat 40% corporate tax rate on all items, including the casualty loss.

Sales	$670,000
Rental income	3,600
Gain on the sale of fixed assets	3,000
General and administrative expenses	110,000
Selling expenses	97,000
Interest expense	1,900
Depreciation for the period	10,000
Extraordinary item (casualty loss—pretax)	30,000
Cost of sales	300,000
Common stock (30,000 shares outstanding)	150,000

Required
a. Prepare a single-step income statement for the year ended December 31, 2008. Include earnings per share for earnings before extraordinary items and net income.
b. Prepare a multiple-step income statement. Include earnings per share for earnings before extraordinary items and net income.

P 4-5. The income statement of Rawl Company for the year ended December 31, 2008, shows the following:

Net sales	$360,000
Cost of sales	190,000
Gross profit	170,000
Selling, general, and administrative expense	80,000
Income before unusual write-offs	90,000
Provision for unusual write-offs	50,000
Earnings from operations before income taxes	40,000
Income taxes	20,000
Net earnings from operations before extraordinary charge	20,000
Extraordinary charge, net of tax of $10,000	(50,000)
Net earnings (loss)	$ (30,000)

Required Compute the net earnings remaining after removing unusual write-offs and the extraordinary charge. Remove these items net of tax. Estimate the tax rate for unusual write-offs based on the taxes on operating income.

P 4-6. At the end of 2008, vandals destroyed your financial records. Fortunately, the controller had kept certain statistical data related to the income statement, as follows:

a. Cost of goods sold was $2,000,000.
b. Administrative expenses were 20% of the cost of sales but only 10% of sales.
c. Selling expenses were 150% of administrative expenses.
d. Bonds payable were $1,000,000, with an average interest rate of 11%.
e. The tax rate was 48%.
f. 50,000 shares of common stock were outstanding for the entire year.

Required From the information given, reconstruct a multiple-step income statement for the year. Include earnings per share.

P 4-7. The following information applies to Bowling Green Metals Corporation for the year ended December 31, 2008:

Total revenues from regular operations	$832,000
Total expenses from regular operations	776,000
Extraordinary gain, net of applicable income taxes	30,000
Dividends paid	20,000
Number of shares of common stock outstanding during the year	10,000

Required Compute earnings per share before extraordinary items and net earnings. Show how this might be presented in the financial statements.

P 4-8. You were recently hired as the assistant treasurer for Victor, Inc. Yesterday, the treasurer was injured in a bicycle accident and is now hospitalized, unconscious. Your boss, Mr. Fernandes, just informed you that the financial statements are due today. Searching through the treasurer's desk, you find the following notes:

a. Income from continuing operations, based on computations done so far, is $400,000. No taxes are accounted for yet. The tax rate is 30%.
b. Dividends declared and paid were $20,000. During the year, 100,000 shares of stock were outstanding.
c. The corporation experienced an uninsured $20,000 pretax loss from a freak hailstorm. Such a storm is considered to be unusual and infrequent.
d. The company decided to change its inventory pricing method from average cost to the FIFO method. The effect of this change is to increase prior years' income by $30,000 pretax. The FIFO method has been used for 2008. (*Hint:* This adjustment should be placed just prior to net income.)
e. In 2008, the company settled a lawsuit against it for $10,000 pretax. The settlement was not previously accrued and is due for payment in February 2009.
f. In 2008, the firm sold a portion of its long-term securities at a gain of $30,000 pretax.
g. The corporation disposed of its consumer products division in August 2008, at a loss of $90,000 pretax. The loss from operations through August was $60,000 pretax.

Required Prepare an income statement for 2008, in good form, starting with income from continuing operations. Compute earnings per share for income from continuing operations, discontinued operations, extraordinary loss, cumulative effect of a change in accounting principle, and net income.

P 4-9. List the statement on which each of the following items may appear. Choose from (A) income statement, (B) balance sheet, or (C) neither.

a. Net income
b. Cost of goods sold
c. Gross profit
d. Retained earnings
e. Paid-in capital in excess of par
f. Sales
g. Supplies expense
h. Investment in G. Company
i. Dividends
j. Inventory
k. Common stock
l. Interest payable
m. Loss from flood
n. Land
o. Taxes payable
p. Interest income
q. Gain on sale of property
r. Dividend income
s. Depreciation expense
t. Accounts receivable
u. Accumulated depreciation
v. Sales commissions

P 4-10. List where each of the following items may appear. Choose from (A) income statement, (B) balance sheet, or (C) reconciliation of retained earnings.

a. Dividends paid
b. Notes payable
c. Minority share of earnings
d. Accrued payrolls
e. Loss on disposal of equipment
f. Minority interest in consolidated subsidiary
g. Adjustments of prior periods
h. Redeemable preferred stock
i. Treasury stock
j. Extraordinary loss
k. Unrealized exchange gains and losses
l. Equity in net income of affiliates
m. Goodwill
n. Unrealized decline in market value of equity investment
o. Cumulative effect of change in accounting principle
p. Common stock
q. Cost of goods sold
r. Supplies
s. Land

P 4-11. The income statement of Tawls Company for the year ended December 31, 2008, shows the following:

Revenue from sales		$ 980,000
Cost of products sold		510,000
Gross profit		470,000
Operating expenses:		
Selling expenses	$110,000	
General expenses	140,000	250,000
Operating income		220,000
Equity on earnings of nonconsolidated subsidiary		60,000
Operating income before income taxes		280,000
Taxes related to operations		100,000
Net income from operations		180,000
Extraordinary loss from flood (less applicable taxes of $50,000)		(120,000)
Minority share of earnings		(40,000)
Net income		$ 20,000

Required
a. Compute the net earnings remaining after removing nonrecurring items.
b. Determine the earnings from the nonconsolidated subsidiary.
c. For the subsidiary that was not consolidated, what amount of income would have been included if this subsidiary had been consolidated?
d. What earnings relate to minority shareholders of a subsidiary that was consolidated?
e. Determine the total tax amount.

P 4-12. The income statement of Jones Company for the year ended December 31, 2008, follows.

Revenue from sales		$790,000
Cost of products sold		410,000
Gross profit		380,000
Operating expenses:		
Selling expenses	$ 40,000	
General expenses	80,000	120,000
Operating income		260,000
Equity in earnings of nonconsolidated subsidiaries (loss)		(20,000)
Operating income before income taxes		240,000
Taxes related to operations		(94,000)
Net income from operations		146,000
Discontinued operations:		
Loss from operations of discontinued segment (less applicable income tax credit of $30,000)	$ (70,000)	
Loss on disposal of segment (less applicable income tax credit of $50,000)	(100,000)	(170,000)
Income before cumulative effect of change in accounting principle		(24,000)
Cumulative effect of change in accounting principle (less applicable income taxes of $25,000)		50,000
Net income		$ 26,000

Required
a. Compute the net earnings remaining after removing nonrecurring items.
b. Determine the earnings (loss) from the nonconsolidated subsidiary.
c. Determine the total tax amount.

P 4-13. Uranium Mining Company, founded in 1980 to mine and market uranium, purchased a mine in 1981 for $900 million. It estimated that the uranium had a market value of $150 per ounce. By 2008, the market value had increased to $300 per ounce. Records for 2008 indicate the following:

Production	200,000 ounces
Sales	230,000 ounces
Deliveries	190,000 ounces

Cash collection	210,000 ounces
Costs of production including depletion*	$50,000,000
Selling expense	$2,000,000
Administrative expenses	$1,250,000
Tax rate	50%

*Production cost per ounce has remained constant over the last few years, and the company has maintained the same production level.

Required a. Compute the income for 2008, using each of the following bases:
1. Receipt of cash
2. Point of sale
3. End of production
4. Based on delivery

b. Comment on when each of the methods should be used. Which method should be used by Uranium Mining Company?

P 4-14. Each of the following statements represents a decision made by the accountant of Growth Industries:

a. A tornado destroyed $200,000 in uninsured inventory. This loss is included in the cost of goods sold.
b. Land was purchased 10 years ago for $50,000. The accountant adjusts the land account to $100,000, which is the estimated current value.
c. The cost of machinery and equipment is charged to a fixed asset account. The machinery and equipment will be expensed over the period of use.
d. The value of equipment increased this year, so no depreciation of equipment was recorded this year.
e. During the year, inventory that cost $5,000 was stolen by employees. This loss has been included in the cost of goods sold for the financial statements. The total amount of the cost of goods sold was $1,000,000.
f. The president of the company, who owns the business, used company funds to buy a car for personal use. The car was recorded on the company's books.

Required State whether you agree or disagree with each decision.

P 4-15. The following information for Gaffney Corporation covers the year ended December 31, 2008:

GAFFNEY CORPORATION
Income Statement
For the Year Ended December 31, 2008

Revenue:		
Revenues from sales		$450,000
Other		5,000
Total revenue		455,000
Expenses:		
Cost of products sold	$280,000	
Selling expenses	50,000	
Administrative and general expenses	20,000	
Federal and state income taxes	30,000	
Total expenses		380,000
Net income		75,000
Other comprehensive income		
Available-for-sale securities adjustment, net of $5,000 income tax	$ 7,000	
Foreign currency translation adjustment, net of $3,000 income tax	8,000	
Other comprehensive income		15,000
Comprehensive income		$ 90,000

Required

a. Will net income or comprehensive income tend to be more volatile? Comment.
b. Which income figure will be used to compute earnings per share?
c. What is the total tax expense reported?
d. Will the items within other comprehensive income always net out as an addition to net income? Comment.

P 4-16.

Required

Answer the following multiple-choice questions:

a. Which of the following items would be classified as operating revenue or expense on an income statement of a manufacturing firm?
   1. Interest expense
   2. Advertising expense
   3. Equity income
   4. Dividend income
   5. Cumulative effect of change in accounting principle
b. Which of the following is a recurring item?
   1. Error of a prior period
   2. Equity in earnings of nonconsolidated subsidiaries
   3. Extraordinary loss
   4. Cumulative effect of change in accounting principle
   5. Discontinued operations
c. The following relate to the income statement of Growth Company for the year ended 2008. What is the beginning inventory?

Purchases	$180,000
Purchase returns	5,000
Sales	240,000
Cost of goods sold	210,000
Ending inventory	30,000

   1. $6,000
   2. $65,000
   3. $50,000
   4. $55,000
   5. $70,000
d. Which of the following items are considered to be nonrecurring items?
   1. Equity earnings
   2. Unusual or infrequent item disclosed separately
   3. Discontinued operations
   4. Extraordinary item
   5. Cumulative effect of change in accounting principle
e. If the investor company owns 30% of the stock of the investee company and the investee company reports profits of $150,000, then the investor company reports equity income of
   1. $25,000.
   2. $35,000.
   3. $45,000.
   4. $50,000.
   5. $55,000.
f. Which of the following would be classified as an extraordinary item on the income statement?
   1. Loss from tornado
   2. Loss on disposal of a segment of business
   3. Write-down of inventory
   4. Correction of an error of the current period
   5. Loss from strike

g. Which of the following is true when a cash dividend is declared and paid?
   1. The firm is left with a liability to pay the dividend.
   2. Retained earnings is reduced by the amount of the dividend.
   3. Retained earnings is increased by the amount of the dividend.
   4. Retained earnings is not influenced by the dividend.
   5. Stockholders' equity is increased.
h. Which of the following is true when a 10% stock dividend is declared and distributed?
   1. Retained earnings is increased.
   2. Stockholders' equity is increased.
   3. Stockholders' equity is decreased.
   4. Authorized shares are increased.
   5. The overall effect is to leave stockholders' equity in total and each owner's share of stockholders' equity is unchanged; however, the total number of shares increases.

P 4-17.

Required Answer the following multiple-choice questions:

a. The following relate to Owens data in 2008. What is the ending inventory?

Purchases	$580,000
Beginning inventory	80,000
Purchase returns	8,000
Sales	900,000
Cost of goods sold	520,000

   1. $150,000
   2. $132,000
   3. $152,000
   4. $170,000
   5. $142,000
b. Changes in account balances of Gross Flowers during 2008 were as follows:

	Increase
Assets	$400,000
Liabilities	150,000
Capital stock	120,000
Additional paid-in capital	110,000

   Assuming there were no charges to retained earnings other than dividends of $20,000, the net income (loss) for 2008 was
   1. $(20,000).
   2. $(40,000).
   3. $20,000.
   4. $40,000.
   5. $60,000.
c. Which of the following would be classified as an extraordinary item on the income statement?
   1. Loss on disposal of a segment of business
   2. Cumulative effect of a change in accounting principle
   3. A sale of fixed assets
   4. An error correction that relates to a prior year
   5. A loss from a flood in a location that would not be expected to flood
d. Minority share of earnings comes from which of the following situations?
   1. A company has been consolidated with our income statement, and our company owns less than 100% of the other company.

2. A company has been consolidated with our income statement, and our company owns 100% of the other company.
3. Our company owns less than 100% of another company, and the statements are not consolidated.
4. Our company owns 100% of another company, and the statements are not consolidated.
5. None of the above

e. Which of the following will *not* be disclosed in retained earnings?
1. Declaration of a stock dividend
2. Adjustment for an error of the current period
3. Adjustment for an error of a prior period
4. Net income
5. Net loss

f. Bell Company has 2,000,000 shares of common stock with par of $10. Additional paid-in capital totals $15,000,000, and retained earnings is $15,000,000. The directors declare a 5% stock dividend when the market value is $10. The reduction of retained earnings as a result of the declaration will be
1. $0.
2. $1,000,000.
3. $800,000.
4. $600,000.
5. None of the above.

g. The stockholders' equity of Gaffney Company at November 30, 2008, is presented below.

Common stock, par value $5, authorized 200,000 shares, 100,000 shares issued and outstanding	$500,000
Paid-in capital in excess of par	100,000
Retained earnings	300,000
	$900,000

On December 1, 2008, the board of directors of Gaffney Company declared a 5% stock dividend, to be distributed on December 20. The market price of the common stock was $10 on December 1 and $12 on December 20. What is the amount of the change to retained earnings as a result of the declaration and distribution of this stock dividend?
1. $0
2. $40,000
3. $50,000
4. $60,000
5. None of the above

h. Schroeder Company had 200,000 shares of common stock outstanding with a $2 par value and retained earnings of $90,000. In 2006, earnings per share were $0.50. In 2007, the company split the stock 2 for 1. Which of the following would result from the stock split?
1. Retained earnings will decrease as a result of the stock split.
2. A total of 400,000 shares of common stock will be outstanding.
3. The par value would become $4 par.
4. Retained earnings will increase as a result of the stock split.
5. None of the above

i. Which of the following is *not* a category within accumulated other comprehensive income?
1. Foreign currency translation adjustments
2. Unrealized holding gains and losses on available-for-sale marketable securities
3. Changes to stockholders' equity resulting from additional minimum pension liability
4. Unrealized gains and losses from derivative instruments
5. Extraordinary item

Case 4-1 HOME BUILDING BLUES

LENNAR CORPORATION AND SUBSIDIARIES*
CONSOLIDATED STATEMENTS OF EARNINGS (in Part)
Years Ended November 30, 2006, 2005, and 2004

	2006	2005	2004
	(Dollars in thousands, except per share amounts)		
Revenues:			
Homebuilding	$15,623,040	$13,304,599	$10,000,632
Financial services	643,622	562,372	500,336
Total revenues	16,266,662	13,866,971	10,500,968
Costs and expenses:			
Homebuilding (1)	14,677,565	11,215,244	8,629,767
Financial services	493,819	457,604	389,605
Corporate general and administrative	193,307	187,257	141,722
Total costs and expenses	15,364,691	11,860,105	9,161,094
Equity in earnings (loss) from unconsolidated entities (2)	(12,536)	133,814	90,739
Management fees and other income, net	66,629	98,952	97,680
Minority interest expense, net	13,415	45,030	10,796
Loss on redemption of 9.95% senior notes	—	34,908	—
Earnings from continuing operations before provision for income taxes	942,649	2,159,694	1,517,497
Provision for income taxes	348,780	815,284	572,855
Net earnings from continuing operations	593,869	1,344,410	944,642
Discontinued operations:			
Earnings from discontinued operations before provision for income taxes	—	17,261	1,570
Provision for income taxes	—	6,516	593
Net earnings from discontinued operations	—	10,745	977
Net earnings	$ 593,869	$ 1,355,155	$ 945,619

(1) Homebuilding costs and expenses include $501.8 million, $20.5 million, and $16.8 million, respectively, of inventory valuation adjustments for the years ended November 30, 2006, 2005, and 2004.

(2) Equity in earnings (loss) from unconsolidated entities includes $126.4 million of valuation adjustments to the Company's investments in unconsolidated entities for the year ended November 30, 2006. There were no material valuation adjustments for the years ended November 30, 2005 and 2004.

Required

a. Would you consider the presentation to be a multiple-step income statement or a single-step income statement? Comment.
b. Does it appear that there is a 100% ownership in all consolidated subsidiaries?
c. If a subsidiary were not consolidated but rather accounted for using the equity method, would this change net income? Explain.
d. Describe equity earnings. Why were these entities not consolidated?
e. What type of "special item" would be Loss on Redemption of 9.95% Senior Notes?
f. Which would likely be considered more important when looking to the future—net earnings from continuing operations or net earnings?
g. Consider homebuilding revenue and homebuilding costs. Comment on the trend in profitability between 2005 and 2006.

*"We are one of the nation's largest homebuilders and a provider of financial services." 10-K

Case 4-2 ENTERTAINMENT PROVIDER

HARRAH'S ENTERTAINMENT, INC.*
CONSOLIDATED STATEMENTS OF INCOME (in Part)

	Years Ended December 31,		
	2006	2005	2004
	(In millions except per share amounts)		
Revenues			
Casino	$ 7,868.6	$ 5,966.5	$3,922.9
Food and beverage	1,577.7	1,086.7	650.9
Rooms	1,240.7	786.2	382.2
Management fees	89.1	75.6	60.6
Other	611.0	424.7	215.9
Less: Casino promotional allowances	(1,713.2)	(1,329.7)	(835.7)
Net revenues	9,673.9	7,010.0	4,396.8
Operating expenses			
Direct			
Casino	3,902.6	2,984.6	1,972.5
Food and beverage	697.6	482.3	275.1
Rooms	256.6	151.5	66.7
Property general, administrative and other	2,206.8	1,464.4	898.1
Depreciation and amortization	667.9	485.7	313.1
Write-downs, reserves and recoveries (Note 10)	83.3	194.7	9.6
Project opening costs	20.9	16.4	9.4
Corporate expense	177.5	97.7	66.8
Merger and integration costs	37.0	55.0	2.3
(Income)/losses on interests in nonconsolidated affiliates (Note 16)	(3.6)	(1.2)	0.9
Amortization of intangible assets (Note 5)	70.7	49.9	9.5
Total operating expenses	8,117.3	5,981.0	3,624.0
Income from operations	1,556.6	1,029.0	772.8
Interest expense, net of interest capitalized (Note 12)	(670.5)	(479.6)	(269.3)
Losses on early extinguishments of debt (Note 8)	(62.0)	(3.3)	—
Other income, including interest income	10.7	8.0	9.5
Income from continuing operations before income taxes and minority interests	834.8	554.1	513.0
Provision for income taxes (Note 11)	(295.6)	(225.9)	(185.1)
Minority interests	(15.3)	(11.9)	(8.6)
Income from continuing operations	523.9	316.3	319.3
Discontinued operations (Note 4)			
Income from discontinued operations (including gains on disposals of $10.9, $119.6 and $0.0)	16.4	16.6	72.4
Provisions for income taxes	(4.5)	(96.5)	(24.0)
Income/(loss) from discontinued operations	11.9	(79.9)	48.4
Net income	$ 535.8	$ 236.4	$ 367.7

Required

a. Would you consider the presentation to be a multiple-step income statement or a single-step income statement?
b. Does it appear there is a 100% ownership in all consolidated subsidiaries? Comment.
c. If a subsidiary were not consolidated but rather accounted for using the equity method, would this change net income? Explain.
d. Describe (Income)/Losses on Interests in Nonconsolidated Affiliates. What is this account normally called?
e. What type of "special item" is Losses on Early Extinguishments of Debt?
f. Which would likely be considered more important when looking to the future—income from continuing operations or net income?

*"Harrah's Entertainment, Inc. . . . is one of the largest casino entertainment providers in the world." 10-K

Case 4-3 APPAREL EXTRAORDINARY

PERRY ELLIS INTERNATIONAL, INC. AND SUBSIDIARIES*
CONSOLIDATED STATEMENTS OF INCOME (in Part)
FOR THE YEARS ENDED JANUARY 31,
(Amounts in thousands, except per share data)

	2007	2006	2005
Revenues			
Net sales	$807,616	$827,504	$633,774
Royalty income	22,226	21,910	22,807
Total revenues	829,842	849,414	656,581
Cost of sales	554,046	586,900	448,531
Gross profit	275,796	262,514	208,050
Operating expenses			
Selling, general and administrative expenses	204,883	195,236	153,282
Depreciation and amortization	11,608	9,557	6,557
Total operating expense	216,491	204,793	159,839
Operating income	59,305	57,721	48,211
Costs on early extinguishment of debt	2,963	—	—
Interest expense	21,114	21,930	14,575
Income before minority interest and income tax provision	35,228	35,791	33,636
Minority interest	508	470	467
Income tax provision	12,311	12,639	12,207
Net income	$ 22,409	$ 22,682	$ 20,962

Required

a. What type of “special item” would be Costs on Early Extinguishment of Debt?
b. Does it appear that there is a 100% ownership in all consolidated subsidiaries? Comment.
c. What type of year-end is being used?

*“We are one of the leading apparel companies in the United States.” 10-K

Case 4-4 THE BIG ORDER

On October 15, 1990, United Airlines (UAL Corporation) placed the largest wide-body aircraft order in commercial aviation history—60 Boeing 747-400s and 68 Boeing 777s—with an estimated value of $22 billion. With this order, United became the launch customer for the B777. This order was equally split between firm orders and options.

Required

a. Comment on when United Airlines should record the purchase of these planes.
b. Comment on when Boeing should record the revenue from selling these planes.
c. Speculate on how firm the commitment was on the part of United Airlines to accept delivery of these planes.
d. 1. Speculate on the disclosure for this order in the 1990 financial statements and notes of United Airlines.
   2. Speculate on the disclosure for this order in the 1990 annual report of United Airlines. (Exclude the financial statements and notes.)
e. 1. Speculate on the disclosure for this order in the 1990 financial statements and notes of Boeing.
   2. Speculate on the disclosure for this order in the 1990 annual report of Boeing. (Exclude the financial statements and notes.)

Case 4-5

CELTICS

Boston Celtics Limited Partnership II and Subsidiaries presented these consolidated statements of income for 1998, 1997, and 1996.

BOSTON CELTICS LIMITED PARTNERSHIP II AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	For the Year Ended		
	June 30, 1998	June 30, 1997	June 30, 1996
Revenues:			
Basketball regular season	$39,107,960	$31,813,019	$35,249,625
Ticket sales	28,002,469	23,269,159	22,071,992
Television and radio broadcast rights fees	8,569,485	7,915,626	7,458,651
Other, principally promotional advertising	75,679,914	62,997,804	64,780,268
Costs and expenses:			
Basketball regular season			
Team	40,401,643	40,941,156	27,891,264
Game	2,820,107	2,386,042	2,606,218
General and administrative	13,464,566	13,913,893	15,053,333
Selling and promotional	4,819,478	4,680,168	2,973,488
Depreciation	208,162	189,324	140,894
Amortization of NBA franchise and other intangible assets	165,035	164,702	164,703
	61,878,991	62,275,285	48,829,900
	13,800,923	722,519	15,950,368
Interest expense	(6,017,737)	(5,872,805)	(6,387,598)
Interest income	6,402,366	6,609,541	8,175,184
Net realized gains (losses) on disposition of marketable securities and other short-term investments	(18,235)	361,051	(101,138)
Income from continuing operations before income taxes	14,167,317	1,820,306	17,636,816
Provision for income taxes	1,900,000	1,400,000	1,850,000
Income from continuing operations	12,267,317	420,306	15,786,816
Discontinued operations:			
Income from discontinued operations (less applicable income taxes of $30,000)			82,806
Gain from disposal of discontinued operations (less applicable income taxes of $17,770,000)			38,330,907
NET INCOME	12,267,317	420,306	54,200,529
Net income applicable to interests of General Partners	306,216	62,246	1,291,014
Net income applicable to interests of Limited Partners	$11,961,101	$ 358,060	$52,909,515
Per unit:			
Income from continuing operations—basic	$2.45	$0.07	$2.68
Income from continuing operations—diluted	$2.17	$0.06	$2.59
Net income—basic	$2.45	$0.07	$9.18
Net income—diluted	$2.17	$0.06	$8.89
Distributions declared	$2.00	$1.00	$1.50

Required

a. Comment on Amortization of NBA Franchise and Other Intangible Assets.
b. Would the discontinued operations be included in projecting the future? Comment.
c. The costs and expenses include team costs and expenses. Speculate on the major reason for the increase in this expense between 1996 and 1997.
d. What were the major reasons for the increase in income from continuing operations between 1997 and 1998?
e. Speculate on why distributions declared were higher in 1998 than 1996. (Notice that net income was substantially higher in 1996.)

Case 4-6 POLYMER PRODUCTS

MYERS INDUSTRIES, INC. AND SUBSIDIARIES*
Statements of Consolidated Income (in Part)
For the Years Ended December 31, 2006, 2005, and 2004

	2006	2005	2004
Net sales	$779,984,388	$736,880,105	$635,912,379
Cost of sales	572,438,757	555,687,606	464,565,836
Gross profit	207,545,631	181,192,499	171,346,543
Selling	79,340,520	71,796,860	66,631,978
General and administrative	67,282,548	62,400,646	60,071,564
Gain on sale of plants	0	(740,386)	(1,524,598)
	146,623,068	133,457,120	125,178,944
Operating income	60,922,563	47,735,379	46,167,599
Interest			
Income	(146,343)	(340,173)	(434,854)
Expense	15,994,763	15,803,452	13,490,294
	15,848,426	15,463,279	13,055,440
Income from continuing operations before income taxes	45,074,143	32,272,100	33,112,159
Income taxes	16,363,613	12,907,205	12,925,464
Income from continuing operations	28,710,531	19,364,895	20,186,695
Income (loss) from discontinued operations, net of tax	(97,734,686)	7,190,611	5,523,065
Net income (loss)	$ (69,024,155)	$ 26,555,506	$ 25,709,760

Required

a. Comment on Income from Continuing Operations versus Net Income (Loss). Which of these would best reflect the future?
b. What type of "special item" would be Gain on Sale of Plants?
c. Comment on the trend in gross profit.

*"The Company conducts its business activities in four distinct business segments, including three in manufacturing and one in distribution. . . . In our manufacturing segments, we design, manufacture, and market a variety of plastic and rubber products." 10-K

Case 4-7 MULTIPLE INCOME

Shaw Communications, Inc.,* included this information in its annual report.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in Part)

August 31, 2004, 2003, and 2002

[all amounts in thousands of Canadian dollars except per share amounts]

21. UNITED STATES ACCOUNTING PRINCIPLES (in Part)

The consolidated financial statements of the Company are prepared in Canadian dollars in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). The following adjustments and disclosures would be required in order to present these consolidated financial statements in accordance with accounting principles generally accepted in the United States ("US GAAP").

*"Shaw Communications . . . is a diversified Canadian Communications company whose core business is providing broadband cable television, internet and satellite direct-to-home ("DTH") services to over three million customers." Annual report 2004.

(continued)

Case 4-7

MULTIPLE INCOME (Continued)

(a) **Reconciliation to accounting principles generally accepted in the United States**

	2004	2003	2002
Net income (loss) using Canadian GAAP	$ 90,909	$ (46,864)	$(284,629)
Add (deduct) adjustments for:			
Deferred charges (2)	14,424	(9,849)	35,594
Foreign exchange gains (3)	22,899	54,527	1,370
Equity in losses of investees (4)	—	2,001	(19,901)
Entitlement payments on equity instruments (8)	(62,302)	(64,827)	(70,551)
Adjustment to write-down of GT Group Telecom Inc. (11)	—	—	28,374
Income tax effect of adjustments	15,724	18,005	13,631
Effect of future income tax rate reductions on differences	(534)	—	—
Net income (loss) using U.S. GAAP	81,120	(47,007)	(296,112)
Unrealized foreign exchange gain (loss) on translation of self-sustaining foreign operations	(38)	(1,031)	1,513
Unrealized gains on available-for-sale securities, net of tax (7)			
Unrealized holding gains arising during the year	5,456	1,361	59,406
Less: Reclassification adjustments for gains included in net income	(1,055)	(95,879)	(180,425)
	4,363	(95,549)	(119,506)
Adjustment to fair value of derivatives (9)	(67,408)	(224,341)	53,293
Foreign exchange gains on hedged long-term debt (10)	57,704	136,975	—
Minimum liability for pension plan (13)	(3,864)	(1,928)	—
Effect of future income tax rate reductions on differences	(63)	—	—
	(9,268)	(184,843)	(66,213)
Comprehensive income (loss) using U.S. GAAP	$ 71,852	$(231,850)	$(362,325)
Earnings (loss) per share—basic and diluted			
Net income (loss) per share using U.S. GAAP	$0.35	$(0.20)	$(1.28)
Comprehensive income (loss) per share using U.S. GAAP	$0.31	$(1.00)	$(1.56)

Required

a. Observe net income (loss) using Canadian GAAP, net income (loss) using U.S. GAAP, and comprehensive income (loss) using U.S. GAAP. Comment on the materiality of the difference between these numbers.

b. Harmonization of international accounting standards has been a goal for many years. Considering the substantial commerce and flow of capital between Canada and the United States, would it be desirable to have similar accounting standards? Comment.

c. Do you think that harmonization of international accounting will be achieved in the near future? In the long run? Comment.

Web Case

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Endnotes

1. *Accounting Trends & Techniques* (New York, NY: American Institute of Certified Public Accountants, 2006), p. 295.
2. Michael L. Roberts, William D. Samson, and Michael T. Dugan, "The Stockholders' Equity Section: Form Without Substance," *Accounting Horizon* (December 1990), pp. 35–46.
3. Ibid., p. 36.