

## CHAPTER 4

## INCOME STATEMENT AND RELATED INFORMATION

This IFRS Supplement provides expanded discussions of accounting guidance under International Financial Reporting Standards (IFRS) for the topics in Intermediate Accounting. The discussions are organized according to the chapters in *Intermediate Accounting* (13<sup>th</sup> or 14<sup>th</sup> Editions) and therefore can be used to supplement the U.S. GAAP requirements as presented in the textbook. Assignment material is provided for each supplement chapter, which can be used to assess and reinforce student understanding of IFRS.

## FORMAT OF THE INCOME STATEMENT

### Elements of the Income Statement

Net income results from revenue, expense, gain, and loss transactions. The income statement summarizes these transactions. This method of income measurement, the **transaction approach**, focuses on the income-related activities that have occurred during the period.<sup>1</sup> The statement can further classify income by customer, product line, or function or by operating and non-operating, and continuing and discontinued. The two major elements of the income statement are as follows.

#### ELEMENTS OF FINANCIAL STATEMENTS

**INCOME.** Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from shareholders.

**EXPENSES.** Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to shareholders. [1]

The definition of income includes both revenues and gains. Revenues arise from the ordinary activities of a company and take many forms, such as sales, fees, interest, dividends, and rents. Gains represent other items that meet the definition of income and may or may not arise in the ordinary activities of a company. Gains include, for example, gains on the sale of long-term assets or unrealized gains on trading securities.

The definition of expenses includes both expenses and losses. Expenses generally arise from the ordinary activities of a company and take many forms, such as cost of goods sold, depreciation, rent, salaries and wages, and taxes. Losses represent other items that meet the definition of expenses and may or may not arise in the ordinary activities of a company. Losses include losses on restructuring charges, losses related to sale of long-term assets, or unrealized losses on trading securities.<sup>2</sup>

<sup>1</sup>The most common alternative to the transaction approach is the **capital maintenance approach** to income measurement. Under this approach, a company determines income for the period based on the change in equity, after adjusting for capital contributions (e.g., investments by owners) or distributions (e.g., dividends). The main drawback associated with the capital maintenance approach is that the components of income are not evident in its measurement. Various tax authorities use the capital maintenance approach to identify unreported income and refers to this approach as the “net worth check.”

<sup>2</sup>The IASB takes the position that income includes both revenues and gains because they both increase economic benefits. Similarly, expenses include both expenses and losses because they both decrease economic benefits.

#### U.S. GAAP PERSPECTIVE



U.S. GAAP defines revenues, expenses, gains, and losses as it relates to the income statement. IFRS only defines income and expenses.

When gains and losses are reported on an income statement, they are generally separately disclosed because knowledge of them is useful for assessing future cash flows. For example, when **McDonald's** (USA) sells a hamburger, it records the selling price as revenue. However, when McDonald's sells land, it records any excess of the selling price over the book value as a gain. This difference in treatment results because the sale of the hamburger is part of McDonald's regular operations. The sale of land is not.

We cannot overemphasize the importance of reporting these elements. Most decision-makers find the *parts* of a financial statement to be more useful than the whole. As we indicated earlier, investors and creditors are interested in predicting the amounts, timing, and uncertainty of future income and cash flows. Having income statement elements shown in some detail and in comparison with prior years' data allows decision-makers to better assess future income and cash flows.

## Minimum Disclosures

As indicated above, disclosing components in an income statement helps users to understand the financial performance for the current year and provides a basis for predicting future results. IFRS does not specify a particular set of components that must be used to report income statement information. However, at a minimum, the following items are required to be presented on the income statement. [2]<sup>3</sup>

- Revenue: Inflow of economic benefits during a period arising from ordinary activities.
- Tax expense.
- Finance costs (hereafter referred to as interest expense).
- Share of the profit or loss of associates and joint ventures accounted for using the equity method.
- A single amount comprising the total of:
  - (i) The post-tax profit or loss of discontinued operations and
  - (ii) The post-tax gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.
- Net income or net loss (sometimes referred to as net profit or loss).

In addition, IFRS notes that additional line items, headings, and subtotals shall be presented on the face of the income statement when such presentation is relevant to an understanding of the company's financial performance.

## Intermediate Components of the Income Statement

It is common for companies to present some or all of the following sections and totals within the income statement.

<sup>3</sup>If a company prepares a statement of comprehensive income, then disclosure is required for (1) other comprehensive income classified by nature, (2) comprehensive income of associates and joint ventures, and (3) total comprehensive income. The statement of comprehensive income is discussed in more detail later in the chapter.

**ILLUSTRATION 4-1**  
Income Statement Format

1. <b>Sales or Revenue Section.</b> Presents sales, discounts, allowances, returns, and other related information. Its purpose is to arrive at the net amount of sales revenue.
2. <b>Cost of Goods Sold Section.</b> Shows the cost of goods sold to produce the sales.
<b>Gross Profit.</b> Revenue less cost of goods sold.
3. <b>Selling Expenses.</b> Reports expenses resulting from the company's efforts to make sales.
4. <b>Administrative or General Expenses.</b> Reports expenses of general administration.
5. <b>Other Income and Expense.</b> Includes most other transactions that do not fit into the revenues and expenses categories provided above. Items such as gains and losses on sales of long-lived assets, impairments of assets, and restructuring charges are reported in this section. In addition, revenues such as rent revenue, dividend revenue, and interest revenue are often reported.
<b>Income from Operations.</b> Company's results from normal operations.
6. <b>Financing Costs.</b> A separate item that identifies the financing cost of the company, hereafter referred to as <i>interest expense</i> .
<b>Income before Income Tax.</b> The total income before income tax.
7. <b>Income Tax.</b> A short section reporting taxes levied on income before income tax.
<b>Income from Continuing Operations.</b> A company's results before any gain or loss on discontinued operations. If the company does not have any gain or loss on discontinued operations, this section is not reported and this amount is reported as net income.
8. <b>Discontinued Operations.</b> Gains or losses resulting from the disposition of a component of a company.
<b>Net Income.</b> The net results of the company's performance over a period of time.
9. <b>Non-Controlling Interest.</b> Presents an allocation of net income to the primary shareholders and to the non-controlling interest (also referred to as <i>minority interest</i> ).
10. <b>Earnings per Share.</b> Per share amounts that are reported.

**Illustration**

Illustration 4-2 presents an income statement for Boc Hong Company. Boc Hong's income statement includes all of the major items in the list above, except for discontinued operations. In arriving at net income, the statement presents the following subtotals and totals: gross profit, income from operations, income before income tax, and net income.

**ILLUSTRATION 4-2**  
 Income Statement

BOC HONG COMPANY INCOME STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2011			
<b>Sales revenue</b>			
Sales			\$3,053,081
Less: Sales discounts	\$ 24,241		
Sales returns and allowances	56,427		80,668
Net sales revenue			2,972,413
<b>Cost of goods sold</b>			<u>1,982,541</u>
<b>Gross profit</b>			<b>989,872</b>
<b>Selling expenses</b>			
Sales salaries and commissions	\$202,644		
Sales office salaries	59,200		
Travel and entertainment	48,940		
Advertising expense	38,315		
Freight and transportation-out	41,209		
Shipping supplies and expense	24,712		
Postage and stationery	16,788		
Telephone and Internet expense	12,215		
Depreciation of sales equipment	9,005	453,028	
<b>Administrative expenses</b>			
Officers' salaries	186,000		
Office salaries	61,200		
Legal and professional services	23,721		
Utilities expense	23,275		
Insurance expense	17,029		
Depreciation of building	18,059		
Depreciation of office equipment	16,000		
Stationery, supplies, and postage	2,875		
Miscellaneous office expenses	2,612	350,771	803,799
<b>Other income and expense</b>			
Dividend revenue	98,500		
Rental revenue	42,910		
Gain on sale of plant assets	30,000		171,410
<b>Income from operations</b>			<b>357,483</b>
Interest on bonds and notes			126,060
<b>Income before income tax</b>			<b>231,423</b>
Income tax			66,934
<b>Net income for the year</b>			<b>\$ 164,489</b>
<b>Attributable to:</b>			
Shareholders of Boc Hong			\$ 120,000
Non-controlling interest			44,489
<b>Earnings per share</b>			<b>\$1.74</b>

**U.S. GAAP  
PERSPECTIVE**


Presentation of the income statement under U.S. GAAP follows either a single-step or multiple-step format.

## Condensed Income Statements

In some cases, an income statement cannot possibly present all the desired expense detail. To solve this problem, a company includes only the totals of components in the statement of income. It then also prepares supplementary schedules to support the totals. This format may thus reduce the income statement itself to a few lines on a single sheet. For this reason, readers who wish to study all the reported data on operations must give their attention to the supporting schedules. For example, consider the income statement shown in Illustration 4-3 for Boc Hong Company. This statement is a condensed version of the more detailed income statement presented in Illustration 4-2. It is more representative of the type found in practice.

**ILLUSTRATION 4-3**

Condensed Income Statement

BOC HONG COMPANY INCOME STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2011		
Net sales		\$2,972,413
Cost of goods sold		<u>1,982,541</u>
Gross profit		989,872
Selling expenses (see Note D)	\$453,028	
Administrative expenses	<u>350,771</u>	803,799
Other income and expense		<u>171,410</u>
Income from operations		357,483
Interest expense		<u>126,060</u>
Income before income tax		231,423
Income tax		<u>66,934</u>
Net income for the year		<u>\$ 164,489</u>
Attributable to:		
Shareholders of Boc Hong	\$ 120,000	
Non-controlling interest	44,489	
Earnings per share		<u>\$1.74</u>

Illustration 4-4 shows an example of a supporting schedule, cross-referenced as Note D and detailing the selling expenses.

**ILLUSTRATION 4-4**

Sample Supporting Schedule

Note D: Selling expenses	
Sales salaries and commissions	\$202,644
Sales office salaries	59,200
Travel and entertainment	48,940
Advertising expense	38,315
Freight and transportation-out	41,209
Shipping supplies and expense	24,712
Postage and stationery	16,788
Telephone and Internet expense	12,215
Depreciation of sales equipment	<u>9,005</u>
Total selling expenses	<u>\$453,028</u>

How much detail should a company include in the income statement? On the one hand, a company wants to present a simple, summarized statement so that readers can readily discover important factors. On the other hand, it wants to disclose the results of all activities and to provide more than just a skeleton report. As we showed above, the income statement always includes certain basic elements, but companies can present them in various formats.

## REPORTING WITHIN THE INCOME STATEMENT

### Gross Profit

Boc Hong Company's gross profit is computed by deducting cost of goods sold from net sales revenue. The disclosure of net sales revenue is useful because Boc Hong reports regular revenues as a separate item. It discloses unusual or incidental revenues in other income and expense. As a result, analysts can more easily understand and assess trends in revenue from continuing operations.

Similarly, the reporting of gross profit provides a useful number for evaluating performance and predicting future earnings. Statement readers may study the trend in gross profits to understand how competitive pressure affected profit margins.

## Income from Operations

Boc Hong Company determines income from operations by deducting selling and administrative expenses as well as other income and expense from gross profit. Income from operations highlights items that affect regular business activities. As such, it is a metric often used by analysts in helping to predict the amount, timing, and uncertainty of future cash flows.

### U.S. GAAP PERSPECTIVE



Under IFRS, companies must classify expenses either by nature or function. U.S. GAAP does not have that requirement. The U.S. SEC requires a functional presentation.

### Expense Classification

Companies are required to present an analysis of expenses classified either by their nature (such as cost of materials used, direct labor incurred, delivery expense, advertising expense, employee benefits, depreciation expense, and amortization expense) or their function (such as cost of goods sold, selling expenses, and administrative expenses).

An advantage of the **nature-of-expense method** is that it is simple to apply because allocations of expense to different functions are not necessary. For manufacturing companies that must allocate costs to the product produced, using a nature-of-expense approach permits companies to report expenses without making arbitrary allocations.

The **function-of-expense method**, however, is often viewed as more relevant because this method identifies the major cost drivers of the company and therefore helps users assess whether these amounts are appropriate for the revenue generated. As indicated, a disadvantage of this method is that the allocation of costs to the varying functions may be arbitrary and therefore the expense classification becomes misleading.

To illustrate these two methods, assume that the accounting firm of Telaris Co. provides audit, tax, and consulting services. It has the following revenues and expenses.

Service revenues	\$400,000
<b>Cost of services</b>	
Staff salaries (related to various services performed)	145,000
Supplies expense (related to various services performed)	10,000
<b>Selling expenses</b>	
Advertising costs	20,000
Entertainment expense	3,000
<b>Administrative expenses</b>	
Utilities expense	5,000
Depreciation on building	12,000

If Telaris Group uses the nature-of-expense approach, its income statement presents each expense item but does not classify the expenses into various subtotals. This approach is shown in Illustration 4-5.

**ILLUSTRATION 4-5**  
Nature-of-Expense  
Approach

TELARIS CO. INCOME STATEMENT FOR THE MONTH OF JANUARY 2011	
Service revenues	\$400,000
Staff salaries	145,000
Supplies expense	10,000
Advertising costs	20,000
Utilities expense	5,000
Depreciation on building	12,000
Entertainment expense	3,000
Net income	<u>\$205,000</u>

If Telaris uses the function-of-expense approach, its income statement is as follows.

TELARIS CO. INCOME STATEMENT FOR THE MONTH OF JANUARY 2011	
Service revenues	\$400,000
Cost of services	155,000
Selling expenses	23,000
Administrative expenses	17,000
Net income	<u>\$205,000</u>

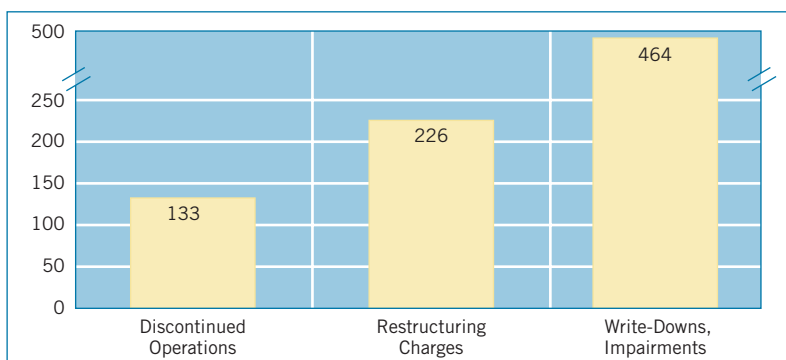
**ILLUSTRATION 4-6**  
Function-of-Expense  
Approach

The function-of-expense method is generally used in practice although many companies believe both approaches have merit. These companies use the function-of-expense approach on the income statement but provide detail of the expenses (as in the nature-of-expense approach) in the notes to the financial statements. For example, Boc Hong's condensed income statement, shown in Illustrations 4-3 and 4-4, indicates how this information might be reported.<sup>4</sup> The IASB-FASB discussion paper on financial statement presentation also recommends the dual approach used in the Boc Hong illustrations. *For homework purposes, use the function-of-expense approach shown in the Boc Hong example in Illustration 4-3 unless directed otherwise.*

### Gains and Losses

What should be included in net income is controversial. For example, should companies report gains and losses, and corrections of revenues and expenses of prior years, as part of retained earnings? Or should companies first present them in the income statement and then carry them to retained earnings?

This issue is extremely important because the number and magnitude of these items are substantial. For example, Illustration 4-7 identifies the most common types and number of gains and losses reported in a survey of 600 large companies. Notice that more than 40 percent of the surveyed firms reported restructuring charges, which often contain write-offs and other one-time items. About 20 percent of the surveyed firms reported a discontinued operation charge. And many companies recorded an asset write-down or a gain on a sale of an asset.<sup>5</sup>



IFRS does not define key measures, such as income from operations. U.S. SEC rules define many key measures and provide requirements and limitations on non-U.S. GAAP presentation (referred to as "pro-forma" reporting).

**ILLUSTRATION 4-7**  
Number of Unusual Items  
Reported in a Recent Year  
by 600 Large Companies

<sup>4</sup>Manufacturing companies that follow the nature-of-expense method generally report direct labor, raw materials used, and changes in inventory related to work in process and finished goods. The overhead items are listed as basic expenses. If the function-of-expense method is used, depreciation expense, amortization expense, and labor costs must also be disclosed because this information is considered useful for predicting future cash flows.

<sup>5</sup>*Accounting Trends and Techniques—2009* (New York: AICPA).



As our opening story discusses, we need consistent and comparable income reporting practices to avoid “promotional” information reported by companies. Developing a framework for reporting these gains and losses is important to ensure reliable income information.<sup>6</sup> Some users argue that the most useful income measure reflects only regular and recurring revenue and expense elements. Unusual, non-recurring items do not reflect a company’s future earning power.

In contrast, others warn that a focus on income that excludes these items potentially misses important information about a company’s performance. Any gain or loss experienced by the company, whether directly or indirectly related to operations, contributes to its long-run profitability. As one analyst notes, “write-offs matter. . . . They speak to the volatility of past earnings.”<sup>7</sup>

**In general, the IASB takes the position that both revenues and expenses and other income and expense should be reported as part of income from operations.** For example, it would be inappropriate to exclude items clearly related to operations (such as inventory write-downs and restructuring and relocation expenses) because they occur irregularly or infrequently, or are unusual in amount. Similarly, it would be inappropriate to exclude items on the grounds that they do not involve cash flows, such as depreciation and amortization expenses. **However, companies can provide additional line items, headings, and subtotals when such presentation is relevant to an understanding of the entity’s financial performance.**

IFRS indicates additional items that may need disclosure on the income statement to help users predict the amount, timing, and uncertainty of future cash flows. Examples of these unusual items are as follows.

- Losses on write-downs of inventories to net realizable value or of property, plant, and equipment to recoverable amount, as well as reversals of such write-downs.
- Losses on restructurings of the activities of a company and reversals of any provisions for the costs of restructuring.
- Gains or losses on the disposal of items of property, plant, and, equipment or investments.
- Litigation settlements.
- Other reversals of liabilities.

Most companies therefore report these items as part of operations and disclose them in great detail if material in amount. Some, for example, simply show each item as a separate item on the income statement before income from operations. Others use the caption **Other income and expense** and then itemize them in this section or in the notes to the financial statements. *For homework purposes, itemize gains, losses, revenues, and expenses that are not reported as part of the revenue and expense sections of the income statement in the “other income and expense” section.*

## Income before Income Tax

Boc Hong computes income before income tax by deducting interest expense (often referred to as *financing costs*) from income from operations. Under IFRS, companies

### U.S. GAAP PERSPECTIVE



Under U.S. GAAP, companies must report an item as extraordinary if it is unusual in nature and infrequent in occurrence. Extraordinary item reporting is prohibited under IFRS.

<sup>6</sup>The IASB and the FASB are working on a joint project on financial statement presentation, which as indicated earlier, is studying how to best report income as well as information presented in the statement of financial position and the statement of cash flows. See [http://www.fasb.org/project/financial\\_statement\\_presentation.shtml](http://www.fasb.org/project/financial_statement_presentation.shtml).

<sup>7</sup>D. McDermott, “Latest Profit Data Stir Old Debate Between Net and Operating Income,” *Wall Street Journal* (May 3, 1999). A recent survey of 600 large public companies [(Accounting Trends and Techniques—2009 (New York: AICPA)] documented that 234 (nearly 40 percent) of the 600 surveyed companies reported a write-down of assets (see also Illustration 4-7). This highlights the importance of good reporting for these unusual items.



must report their financing costs on the income statement. The reason for this requirement is to differentiate between a company's business activities (how it uses capital to create value) and its financing activities (how it obtains capital).

In most cases, the financing costs involve interest expense. In other situations, companies offset against interest expense, items such as interest revenue. Illustration 4-8 indicates how **Network Rail** (GBR) presents its financing costs involving only interest expense.

**ILLUSTRATION 4-8**  
Presentation of Finance  
Costs



### Network Rail

On its income statement:  
(000)

Finance costs	Note 10	£1,014
<b>10 Finance costs</b>		
Interest on bank loans and overdrafts		£ 71
Interest on bonds issued under the debt issuance programme		672
Interest on debt issued under the medium term note programme		253
Interest on commercial paper		12
Interest on obligations under finance leases		16
Other interest		82
Total borrowing costs		1,106
Less: Amounts included in the cost of qualifying assets		92
Total finance costs		£1,014
Borrowing costs are included in the costs of qualifying assets to the extent that the asset is financed by the Group. The average rate used during the year was 5.0% (2007: 5.0%).		

#### 10 Finance costs

Interest on bank loans and overdrafts	£ 71
Interest on bonds issued under the debt issuance programme	672
Interest on debt issued under the medium term note programme	253
Interest on commercial paper	12
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Other interest	82
Total borrowing costs	1,106
Less: Amounts included in the cost of qualifying assets	92
Total finance costs	£1,014

Borrowing costs are included in the costs of qualifying assets to the extent that the asset is financed by the Group. The average rate used during the year was 5.0% (2007: 5.0%).

As indicated, some companies offset interest revenue and interest expense, and identify it as either finance costs or interest expense and interest revenue, net. *For homework purposes, consider only interest expense as financing costs. Interest revenue (income) should be reported as part of other income and expense.*

## Net Income

Boc Hong deducts income tax from income before income tax to arrive at net income. Net income represents the income after all revenues and expenses for the period are considered. It is viewed by many as the most important measure of a company's success or failure for a given period of time.

Income tax is reported on the income statement right before net income because this expense cannot be computed until all revenues and expenses are determined. In practice, an understanding of how the company arrived at the income tax for the period is important. For example, some of the revenue items may have different tax rates associated with them. In other cases, expense items may not be deductible for income tax purposes. Understanding these situations enables users to better predict what the future holds for the company. As a result, there is often extensive disclosure related to how the number for income tax expense is determined. Chapter 19 discusses this subject in detail.

## Allocation to Non-Controlling Interest

Assume that Boc Hong Company owns more than 50 percent of the ordinary shares of LTM Group. In this case, Boc Hong is called the parent company and LTM Group is referred to as a subsidiary company. Because of Boc Hong's share interest, it has a controlling interest in LTM.

**U.S. GAAP  
PERSPECTIVE**

U.S. GAAP does not require companies to indicate the amount of net income attributed to non-controlling interest.

If Boc Hong acquires 100 percent of the shares of LTM, LTM is said to be wholly owned. When Boc Hong's interest in LTM is less than 100 percent, LTM is only partially owned. Under this arrangement, the ownership of LTM is divided into two classes: (1) the majority interest represented by the shareholders who own the controlling interest, and (2) the non-controlling interest (often referred to as the *minority interest*) represented by shareholders who are not part of the controlling group.

If Boc Hong prepares a consolidated income statement that includes LTM, IFRS requires that net income be allocated to the controlling and non-controlling interest. This allocation is reported at the bottom of the income statement after net income. Boc Hong's net income of \$164,489 is therefore allocated as \$120,000 to Boc Hong and \$44,489 to the non-controlling interest. The presentation on the income statement is as follows.

**ILLUSTRATION 4-9**  
Presentation of  
Non-Controlling Interest

Net income	\$164,489
<b>Attributable to:</b>	
Shareholders of Boc Hong	\$120,000
Non-controlling interest	44,489

These amounts are to be presented as allocations of net income or net loss, not as an item of income or expense.

## Earnings per Share

A company customarily sums up the results of its operations in one important figure: net income. However, the financial world has widely accepted an even more distilled and compact figure as the most significant business indicator—**earnings per share** (EPS).

The computation of earnings per share is usually straightforward. **Earnings per share is net income minus preference dividends (income available to ordinary shareholders), divided by the weighted average of ordinary shares outstanding.**<sup>8</sup>

To illustrate, assume that Lancer, Inc. reports net income of \$350,000. It declares and pays preference dividends of \$50,000 for the year. The weighted-average number of ordinary shares outstanding during the year is 100,000 shares. Lancer computes earnings per share of \$3, as shown in Illustration 4-10.

**ILLUSTRATION 4-10**  
Equation Illustrating  
Computation of Earnings  
per Share

$\frac{\text{Net Income} - \text{Preference Dividends}}{\text{Weighted Average of Ordinary Shares Outstanding}} = \text{Earnings per Share}$	
$\frac{\$350,000 - \$50,000}{100,000} = \$3$	

Note that EPS measures the number of dollars earned by each ordinary share. It does not represent the dollar amount paid to shareholders in the form of dividends.

Prospectuses, proxy material, and annual reports to shareholders commonly use the “net income per share” or “earnings per share” ratio. The financial press and securities analysts also highlight EPS. Because of its importance, **companies must disclose earnings per share on the face of the income statement.**

Many corporations have simple capital structures that include only ordinary shares. For these companies, a presentation such as “Earnings per share” is appropriate on the

<sup>8</sup>In calculating earnings per share, companies deduct preference dividends from net income if the dividends are declared or if they are cumulative though not declared. In addition, any amount allocated to the non-controlling interest should be deducted from net income in determining earnings per share.

income statement. In many instances, however, companies' earnings per share are subject to dilution (reduction) in the future because existing contingencies permit the issuance of additional shares. [3]<sup>9</sup>

In summary, the simplicity and availability of EPS figures lead to their widespread use. Because of the importance that the public, even the well-informed public, attaches to earnings per share, companies must make the EPS figure as meaningful as possible.

## Discontinued Operations

As Illustration 4-7 shows, one of the most common types of unusual items is discontinued operations. The IASB defines a **discontinued operation** as a component of an entity that either has been disposed of, or is classified as held-for-sale, and:

1. Represents a major line of business or geographical area of operations, or
2. Is part of a single, co-coordinated plan to dispose of a major line of business or geographical area of operations, or
3. Is a subsidiary acquired exclusively with a view to resell. [4]

To illustrate a **component**, **S. C. Johnson** (USA) manufactures and sells consumer products. It has several product groups, each with different product lines and brands. For S. C. Johnson, a product group is the lowest level at which it can clearly distinguish the operations and cash flows from the rest of the company's operations. Therefore, each product group is a component of the company. If a component were disposed of, S. C. Johnson would classify it as a discontinued operation.

Here is another example. Assume that Softso Inc. has experienced losses with certain brands in its beauty-care products group. As a result, Softso decides to sell that part of its business. It will discontinue any continuing involvement in the product group after the sale. In this case, Softso eliminates the operations and the cash flows of the product group from its ongoing operations, and reports it as a discontinued operation.

On the other hand, assume Softso decides to remain in the beauty-care business but will discontinue the brands that experienced losses. Because Softso cannot differentiate the cash flows from the brands from the cash flows of the product group as a whole, it cannot consider the brands a component. Softso does not classify any gain or loss on the sale of the brands as a discontinued operation.

Companies report as discontinued operations (in a separate income statement category) the gain or loss from **disposal of a component of a business**. In addition, companies report the **results of operations of a component that has been or will be disposed of** separately from continuing operations. Companies show the effects of discontinued operations net of tax as a separate category, after continuing operations.

To illustrate, Multiplex Products, Inc., a highly diversified company, decides to discontinue its electronics division. During the current year, the electronics division lost \$300,000 (net of tax). Multiplex sold the division at the end of the year at a loss of \$500,000 (net of tax). Illustration 4-11 shows the reporting of discontinued operations for Multiplex.

Income from continuing operations		\$20,000,000
Discontinued operations		
Loss from operation of discontinued electronics division (net of tax)	\$300,000	
Loss from disposal of electronics division (net of tax)	500,000	800,000
Net income		<u>\$19,200,000</u>

**ILLUSTRATION 4-11**  
Income Statement  
Presentation of  
Discontinued Operations

<sup>9</sup>We discuss the computational problems involved in accounting for these dilutive securities in earnings per share computations in Chapter 16.

Companies use the phrase “**Income from continuing operations**” only when gains or losses on discontinued operations occur.<sup>10</sup>

A company that reports a discontinued operation must report per share amounts for the line item either on the face of the income statement or in the notes to the financial statements. [5] To illustrate, consider the income statement for Poquito Industries Inc., shown in Illustration 4-12. Notice the order in which Poquito shows the data, with per share information at the bottom. Assume that the company had 100,000 shares outstanding for the entire year. The Poquito income statement, as Illustration 4-12 shows, is highly condensed. Poquito would need to describe items such as “Other income and expense” and “Discontinued operations” fully and appropriately in the statement or related notes.

**ILLUSTRATION 4-12**  
Income Statement

POQUITO INDUSTRIES INC. INCOME STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2011			
Sales revenue			\$1,420,000
Cost of goods sold			<u>600,000</u>
Gross profit			820,000
Selling and administrative expenses			<u>320,000</u>
Other income and expense			
Interest revenue	\$ 10,000		
Loss on disposal of part of Textile Division	(5,000)		
Loss on sale of investments	<u>(30,000)</u>		<u>(25,000)</u>
Income from operations			475,000
Interest expense			<u>15,000</u>
Income before income tax			460,000
Income tax			<u>184,000</u>
Income from continuing operations			276,000
Discontinued operations			
Income from operations of Pizza Division, less applicable income tax of \$24,800	54,000		
Loss on disposal of Pizza Division, less applicable income tax of \$41,000	<u>(90,000)</u>		<u>(36,000)</u>
Net income			<u>\$240,000</u>
Per share			
Income from continuing operations			\$2.76
Income from operations of discontinued division, net of tax			0.54
Loss on disposal of discontinued operation, net of tax			<u>(0.90)</u>
Net income			<u>\$2.40</u>

## Retained Earnings Statement

Net income increases retained earnings. A net loss decreases retained earnings. Both cash and share dividends decrease retained earnings. Changes in accounting principles (generally) and prior period adjustments may increase or decrease retained earnings. Companies charge or credit these adjustments (net of tax) to the opening balance of retained earnings. This excludes the adjustments from the determination of net income for the current period.

<sup>10</sup>In practice, a company will generally report only one line on the income statement, such as “Loss on discontinued operations,” and then in the notes explain the two components of the loss that total \$800,000. For homework purposes, report both amounts on the face of the income statement, net of tax, if both amounts are provided.

Companies may show retained earnings information in different ways. For example, some companies prepare a separate retained earnings statement, as Illustration 4-13 shows.

STRICKER INC. RETAINED EARNINGS STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2011	
Retained earnings, January 1, as reported	\$1,050,000
Correction for understatement of net income in prior period (inventory error)	50,000
Retained earnings, January 1, as adjusted	1,100,000
Add: Net income	360,000
	1,460,000
Less: Cash dividends	\$100,000
Share dividends	200,000
	300,000
Retained earnings, December 31	\$1,160,000

**ILLUSTRATION 4-13**  
Retained Earnings  
Statement

The reconciliation of the beginning to the ending balance in retained earnings provides information about why net assets increased or decreased during the year. The association of dividend distributions with net income for the period indicates what management is doing with earnings: It may be “plowing back” into the business part or all of the earnings, distributing all current income, or distributing current income plus the accumulated earnings of prior years.

### Restrictions of Retained Earnings

Companies often restrict retained earnings to comply with contractual requirements, board of directors’ policy, or current necessity. Generally, companies disclose in the notes to the financial statements the amounts of restricted retained earnings. In some cases, companies transfer the amount of retained earnings restricted to an account titled **Appropriated Retained Earnings**. The retained earnings section may therefore report two separate amounts—(1) retained earnings free (unrestricted) and (2) retained earnings appropriated (restricted). The total of these two amounts equals the total retained earnings.

### Comprehensive Income

Companies generally include in income all revenues, expenses, and gains and losses recognized during the period. These items are classified within the income statement so that financial statement readers can better understand the significance of various components of net income. Changes in accounting principle and corrections of errors are excluded from the calculation of net income because their effects relate to prior periods.

In recent years, there is increased use of fair values for measuring assets and liabilities. Furthermore, possible reporting of gains and losses related to changes in fair value have placed a strain on income reporting. Because fair values are continually changing, some argue that recognizing these gains and losses in net income is misleading. The IASB agrees and has identified a limited number of transactions that should be recorded directly to equity. One example is unrealized gains and losses on non-trading equity securities.<sup>11</sup> These gains and losses are excluded from net income, thereby reducing

#### U.S. GAAP PERSPECTIVE



U.S. GAAP provides three possible formats for presenting comprehensive income: (1) single statement, (2) combined statement of comprehensive income, and (3) in the statement of stockholders’ equity. Most U.S. companies report this information in the statement of stockholders’ equity.

<sup>11</sup>We further discuss non-trading equity securities in Chapter 17. Additional examples of other comprehensive items are translation gains and losses on foreign currency, unrealized gains and losses on certain hedging transactions (Chapter 17 Appendix), actuarial gains and losses in certain situations (Chapter 20), and changes in revaluation surplus (Chapters 11 and 12).

volatility in net income due to fluctuations in fair value. At the same time, disclosure of the potential gain or loss is provided.

Companies include these items that bypass the income statement in a measure called comprehensive income. **Comprehensive income** includes all changes in equity during a period *except* those resulting from investments by owners and distributions to owners. Comprehensive income, therefore, includes the following: all revenues and gains, expenses and losses reported in net income, and all gains and losses that bypass net income but affect equity. These items—non-owner changes in equity that bypass the income statement—are referred to as **other comprehensive income**.

The IASB decided that companies must display the components of other comprehensive income in one of two ways: **(1) a second income statement or (2) a combined statement of comprehensive income**. Regardless of the format used, companies must add net income to other comprehensive income to arrive at comprehensive income. Companies are not required to report earnings per share information related to comprehensive income.<sup>12</sup>

To illustrate, assume that V. Gill Inc. reports the following information for 2011: sales revenue \$800,000; cost of goods sold \$600,000; operating expenses \$90,000; and an unrealized holding gain on non-trading equity securities of \$30,000, net of tax.

### Second Income Statement

Illustration 4-14 shows the two-income statement format based on the above information for V. Gill. Reporting comprehensive income in a separate statement indicates that the gains and losses identified as other comprehensive income have the same status as traditional gains and losses. Placing net income as the starting point in the comprehensive income statement highlights the relationship of the statement to the traditional income statement.

#### ILLUSTRATION 4-14

Two-Statement Format:  
Comprehensive Income

V. GILL INC. INCOME STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2011	
Sales revenue	\$800,000
Cost of goods sold	<u>600,000</u>
Gross profit	200,000
Operating expenses	<u>90,000</u>
Net income	<u>\$110,000</u>
V. GILL INC. STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2011	
Net income	\$110,000
Other comprehensive income	
Unrealized holding gain, net of tax	<u>30,000</u>
Comprehensive income	<u>\$140,000</u>

### Combined Statement of Comprehensive Income

The second approach to reporting other comprehensive income provides a **combined statement** of comprehensive income. In this approach, the traditional net income is a

<sup>12</sup>A company must display the components of other comprehensive income either (1) net of related tax effects, or (2) before related tax effects, with one amount shown for the aggregate amount of tax related to the total amount of other comprehensive income. Both alternatives must show each component of other comprehensive income, net of related taxes either on the face of the statement or in the notes.



subtotal, with total comprehensive income shown as a final total. The combined statement has the advantage of not requiring the creation of a new financial statement. However, burying net income as a subtotal on the statement is a disadvantage. Illustration 4-15 shows the combined income statement format for V. Gill.

V. GILL INC. STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2011	
Sales revenue	\$800,000
Cost of goods sold	<u>600,000</u>
Gross profit	200,000
Operating expenses	<u>90,000</u>
Net income	110,000
Other comprehensive income	
Unrealized holding gain, net of tax	<u>30,000</u>
Comprehensive income	<u>\$140,000</u>

**ILLUSTRATION 4-15**  
Combined Statement  
Format: Comprehensive  
Income

## Statement of Changes in Equity

In addition to a statement of comprehensive income, companies are also required to present a **statement of changes in equity**. Equity is generally comprised of share capital—ordinary, share premium—ordinary, retained earnings, and the accumulated balances in other comprehensive income. The statement reports the change in each equity account and in total equity for the period. The following items are disclosed in this statement.

1. Comprehensive income for the period.
2. Contributions (issuances of shares) and distributions (dividends) to owners.
3. Reconciliation of the carrying amount of each component of equity from the beginning to the end of the period.

Companies often prepare the statement of changes in equity in column form. In this format, they use columns for each account and for total equity.

To illustrate, assume the same information for V. Gill as shown in Illustration 4-15. The company had the following equity account balances at the beginning of 2011: Share Capital—Ordinary \$300,000; Retained Earnings \$50,000; and Accumulated Other Comprehensive Income \$60,000, related to unrealized gains on non-trading equity securities. No changes in the Share Capital—Ordinary account occurred during the year. Cash dividends during the period were \$10,000. Illustration 4-16 shows a statement of changes in equity for V. Gill.

V. GILL INC. STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED DECEMBER 31, 2011				
	Share Capital— Ordinary	Retained Earnings	Unrealized Gains on Non-Trading Equity Securities	Total Equity
Beginning balance	\$300,000	\$ 50,000	\$60,000	\$410,000
Total comprehensive income		110,000	30,000	140,000
Dividends		(10,000)		(10,000)
Ending balance	<u>\$300,000</u>	<u>\$150,000</u>	<u>\$90,000</u>	<u>\$540,000</u>

**ILLUSTRATION 4-16**  
Statement of Changes  
in Equity



IFRS results in more items reported in comprehensive income due to revaluations.



Total comprehensive income is comprised of net income of \$110,000 added to retained earnings and \$30,000 related to the unrealized gain. Separate columns are used to report each additional item of other comprehensive income.<sup>13</sup> Thus, this statement is useful for understanding how equity changed during the period.

Regardless of the display format used, V. Gill reports the **accumulated other comprehensive income** of \$90,000 in the equity section of the statement of financial position as follows.<sup>14</sup>

#### ILLUSTRATION 4-17

Presentation of Accumulated Other Comprehensive Income in the Statement of Financial Position

V. GILL INC. STATEMENT OF FINANCIAL POSITION AS OF DECEMBER 31, 2011 (EQUITY SECTION)	
Equity	
Share capital—ordinary	\$300,000
Retained earnings	150,000
<b>Accumulated other comprehensive income</b>	<b>90,000</b>
Total equity	<u>\$540,000</u>

By providing information on the components of comprehensive income, as well as accumulated other comprehensive income, the company communicates information about all changes in net assets.<sup>15</sup> With this information, users will better understand the quality of the company's earnings.

## AUTHORITATIVE LITERATURE

### Authoritative Literature References

- [1] *Framework for Preparation and Presentation of Financial Statement* (London, U.K.: IASB, 2001), par. 70.
- [2] International Accounting Standard 1, *Presentation of Financial Statements* (London, U.K.: IASB, 2007), par. 82.
- [3] International Accounting Standard 33, *Earnings per Share* (London, U.K.: IASB, 2003).
- [4] International Financial Reporting Standard 5, *Non-current Assets Held for Sale and Discontinued Operations* (London, U.K.: IASB, 2004).
- [5] International Accounting Standard 33, *Earnings per Share* (London, U.K.: IASB, 2003).

<sup>13</sup>If a company has non-controlling interest, an additional column would be added to report changes in non-controlling interest amounts.

<sup>14</sup>Many companies use the term Reserve to include all items in equity except for contributed capital. Contributed capital is comprised of Share Capital (ordinary and preference) and Share Premium (ordinary and preference). Rather than the term Reserve, we use Retained Earnings and Accumulated Other Comprehensive Income because these concepts are more descriptive of the items in the equity section.

<sup>15</sup>Corrections of errors and changes in accounting principle are not considered other comprehensive income items.

## QUESTIONS

1. What is the major distinction between income and expenses under IFRS?
2. Do the elements of financial statements, income and expense, include gains and losses? Explain.
3. What are the sections of the income statement that comprise (1) gross profit and (2) income from operations?
4. **Ahold** (NLD), in its consolidated income statement, reported “settlement of securities class action” €803 million loss. In what section of the income statement is this amount reported?
5. Explain where the following items are reported on the income statement: (1) interest expense and (2) income tax expense.
6. Explain the difference between the “nature-of-expense” and “function-of-expense” classifications.
7. Discuss the appropriate treatment in the income statement for the following items:
  - (a) Loss on discontinued operations.
  - (b) Non-controlling interest allocation.
  - (c) Earnings per share.
  - (d) Gain on sale of equipment.
8. Discuss the appropriate treatment in the financial statements of each of the following.
  - (a) Write-down of plant assets due to impairment.
  - (b) A delivery expense on goods sold.
  - (c) Additional depreciation on factory machinery because of an error in computing depreciation for the previous year.
  - (d) Rent received from subletting a portion of the office space.
  - (e) A patent infringement suit, brought 2 years ago against the company by another company, was settled this year by a cash payment of \$725,000.
  - (f) A reduction in the Allowance for Doubtful Accounts balance, because the account appears to be considerably in excess of the probable loss from uncollectible receivables.

## BRIEF EXERCISES

**BE4-1** Presented below is some financial information related to Volaire Group.

Revenues	€800,000
Income from continuing operations	100,000
Comprehensive income	120,000
Net income	90,000
Income from operations	220,000
Selling and administrative expenses	500,000
Income before income tax	200,000

Compute the following: (a) other income and expense, (b) financing costs, (c) income tax, (d) discontinued operations, and (e) other comprehensive income.

**BE4-2** The following information is provided.

Sales revenue	HK\$100,000	Cost of goods sold	HK\$55,000
Gain on sale of plant assets	30,000	Interest expense	5,000
Selling and administrative expenses	10,000	Income tax rate	20%

Determine (a) income from operations, (b) income before income tax, and (c) net income.

**BE4-3** The following information is provided about Caltex Company: income from operations \$430,000; loss on inventory write-downs \$12,000; selling expenses \$62,000; interest expense \$20,000. The tax rate is 30%. Determine net income.

**BE4-4** Indicate in what section (gross profit, income from operations, or income before income tax) the following items are reported: (a) interest revenue, (b) interest expense, (c) loss on impairment of goodwill, (d) sales revenue, and (e) administrative expenses.

**BE4-5** On January 1, 2010, Otano Inc. had cash and share capital of ¥60,000,000. At that date, the company had no other asset, liability, or equity balances. On January 2, 2010, it purchased for cash ¥20,000,000 of equity securities that it classified as non-trading. It received cash dividends of ¥3,000,000 during the year on these securities. In addition, it has an unrealized holding gain on these securities of ¥4,000,000 net of tax. Determine the following amounts for 2010: (a) net income, (b) comprehensive income, (c) other comprehensive income, and (d) accumulated other comprehensive income (end of 2010).

## EXERCISES

**E4-1 (Compute Income Measures)** Presented below is information related to Viel Company at December 31, 2010, the end of its first year of operations.

Sales revenue	€310,000
Cost of goods sold	140,000
Selling and administrative expenses	50,000
Gain on sale of plant assets	30,000
Unrealized gain on non-trading equity securities	10,000
Interest expense	6,000
Loss on discontinued operations	12,000
Allocation to non-controlling interest	40,000
Dividends declared and paid	5,000

### Instructions

Compute the following: (a) income from operations, (b) net income, (c) net income attributable to Viel Company controlling shareholders, (d) comprehensive income, and (e) retained earnings balance at December 31, 2010.

**E4-2 (Computation of Net Income)** Presented below are changes in all account balances of Jackson Furniture Co. during the current year, except for retained earnings.

	Increase (Decrease)		Increase (Decrease)
Cash	£ 69,000	Accounts Payable	£ (51,000)
Accounts Receivable (net)	45,000	Bonds Payable	82,000
Inventory	127,000	Share Capital—Ordinary	138,000
Investments	(47,000)		

### Instructions

Compute the net income for the current year, assuming that there were no entries in the Retained Earnings account except for net income and a dividend declaration of £24,000 which was paid in the current year.

**E4-3 (Income Statement Presentation)** The financial records of Dunbar Inc. were destroyed by fire at the end of 2010. Fortunately, the controller had kept certain statistical data related to the income statement as presented below.

1. The beginning merchandise inventory was \$92,000 and decreased 20% during the current year.
2. Sales discounts amount to \$17,000.
3. 30,000 ordinary shares were outstanding for the entire year.
4. Interest expense was \$20,000.
5. The income tax rate is 30%.
6. Cost of goods sold amounts to \$500,000.
7. Administrative expenses are 18% of cost of goods sold but only 8% of gross sales.
8. Four-fifths of the operating expenses relate to sales activities.

### Instructions

From the foregoing information, prepare an income statement for the year 2010.

**E4-4 (Income Statement Items)** The following balances were taken from the books of Parnevik Corp. on December 31, 2010.

Interest revenue	\$ 86,000	Accumulated depreciation—building	\$ 28,000
Cash	51,000	Notes receivable	155,000
Sales	1,280,000	Selling expenses	194,000
Accounts receivable	150,000	Accounts payable	170,000
Prepaid insurance	20,000	Bonds payable	100,000
Sales returns and allowances	150,000	Administrative and general expenses	97,000
Allowance for doubtful accounts	7,000	Accrued liabilities	32,000
Sales discounts	45,000	Interest expense	60,000
Land	100,000	Notes payable	100,000
Equipment	200,000	Loss from impairment of plant assets	120,000
Building	140,000	Share capital—ordinary	500,000
Cost of goods sold	621,000	Retained earnings	21,000
Accumulated depreciation—equipment	40,000		

Assume the total effective tax rate on all items is 34%.

**Instructions**

Prepare an income statement; 100,000 ordinary shares were outstanding during the year.

**E4-5 (Income Statement)** The accountant of Weatherspoon Shoe Co. has compiled the following information from the company's records as a basis for an income statement for the year ended December 31, 2010.

Rental revenue	\$ 29,000
Interest expense	18,000
Unrealized gain on non-trading equity securities, net of tax	31,000
Selling expenses	140,000
Income tax	30,600
Administrative expenses	181,000
Cost of goods sold	516,000
Net sales	980,000
Cash dividends declared	16,000
Loss on sale of plant assets	15,000

There were 20,000 ordinary shares outstanding during the year.

**Instructions**

- Prepare a comprehensive income statement using the combined statement approach.
- Prepare a comprehensive income statement using the two-statement approach.
- Which format do you prefer? Discuss.

**E4-6 (Comprehensive Income)** Bryant Co. reports the following information for 2010: sales revenue \$750,000; cost of goods sold \$500,000; operating expenses \$80,000; and an unrealized holding loss on non-trading equity securities for 2010 of \$50,000. It declared and paid a cash dividend of \$10,000 in 2010.

Bryant Co. has January 1, 2010, balances in share capital—ordinary \$350,000; accumulated other comprehensive income related to the unrealized holding loss of \$80,000; and retained earnings \$90,000. It issued no ordinary shares during 2010. Ignore income taxes.

**Instructions**

Prepare a statement of changes in equity.

**E4-7 (Changes in Equity)** The equity section of Hasbro Inc. at January 1, 2010, was as follows.

Share capital—ordinary	\$300,000
Accumulated other comprehensive income	
Unrealized holding gain on non-trading equity securities	50,000
Retained earnings	20,000

During the year, the company had the following transactions.

- Issued 10,000 shares at \$3 per share.
- Dividends of \$9,000 were declared and paid.
- Net income for the year was \$100,000.
- Unrealized holding loss of \$5,000 occurred on its non-trading equity securities.

**Instructions**

Prepare a statement of changes in equity for Hasbro Inc.

**E4-8 (Income Components)** Presented below are financial statement classifications for the statement of comprehensive income and the retained earnings statement. For each transaction or account title, enter in the space provided a letter(s) to indicate the usual classification

**Statement of Comprehensive Income**

- |   |                            |
|---|----------------------------|
| A | Revenue                    |
| B | Operating expense          |
| C | Other income or expense    |
| D | Discontinued operations    |
| E | Other comprehensive income |

**Retained Earnings Statement**

- |   |   |
|---|---|
| F | An addition or deduction from beginning balance |
| G | Additions to retained earnings                  |
| H | Deduction from retained earnings                |
| I | Note classification                             |

**Transactions**

1. \_\_\_\_\_ Unrealized holding loss on non-trading equity securities.
2. \_\_\_\_\_ Gain on sale of non-trading equity securities.
3. \_\_\_\_\_ Sales revenue.
4. \_\_\_\_\_ Loss on impairment of goodwill.
5. \_\_\_\_\_ Sales salaries accrued.
6. \_\_\_\_\_ Net income for the period.
7. \_\_\_\_\_ Loss on sale of investments.
8. \_\_\_\_\_ Depreciation on equipment used in operations.
9. \_\_\_\_\_ Cash dividends declared and paid.
10. \_\_\_\_\_ Correction of an error due to expensing the cost of equipment in a previous year.
11. \_\_\_\_\_ Insurance gain on flood loss—insurance proceeds exceed the carrying amount of assets destroyed.
12. \_\_\_\_\_ The company has decided to stop production of its candy division and suffered a loss on the sale of this division.

## CONCEPTS FOR ANALYSIS

**CA4-1 (Comprehensive Income)** Willie Nelson, Jr., controller for Jenkins Corporation, is preparing the company's financial statements at year-end. Currently, he is focusing on the income statement and determining the format for reporting comprehensive income. During the year, the company earned net income of \$400,000 and had unrealized gains on non-trading equity securities of \$15,000. In the previous year, net income was \$410,000, and the company had no unrealized gains or losses.

**Instructions**

- (a) Show how income and comprehensive income will be reported on a comparative basis for the current and prior years, using the separate income statement format.
- (b) Show how income and comprehensive income will be reported on a comparative basis for the current and prior years, using the combined comprehensive income statement format.
- (c) Which format should Nelson recommend?

## USING YOUR JUDGMENT

### FINANCIAL REPORTING

#### Financial Reporting Problem

##### Marks and Spencer plc (M&S)

The financial statements of **M&S** can be accessed at the book's companion website, [www.wiley.com/college/kiesoifrs](http://www.wiley.com/college/kiesoifrs).

**Instructions**

Refer to these financial statements and the accompanying notes to answer the following questions.

- (a) What type of income statement format does M&S use? Indicate why this format might be used to present income statement information.
- (b) What are M&S's primary revenue sources?
- (c) Compute M&S's gross profit for each of the years 2007 and 2008. Explain why gross profit increased in 2008.
- (d) Why does M&S make a distinction between operating and non-operating profit?
- (e) Does M&S report any non-U.S. GAAP measures? Explain.



**BRIDGE TO THE PROFESSION**

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**Professional Research**

Your client took accounting a number of years ago and was unaware of comprehensive income reporting. He is not convinced that any accounting standards exist for comprehensive income.

**Instructions**

Access the IFRS authoritative literature at the IASB website (<http://eifrs.iasb.org/>). When you have accessed the documents, you can use the search tool in your Internet browser to respond to the following questions. (Provide paragraph citations.)

- (a) What IFRS addresses reporting in the statement of comprehensive income? When was it issued?
- (b) Provide the definition of total comprehensive income.
- (c) Explain the rationale for presenting additional line items, headings, and subtotals in the statement of comprehensive income.
- (d) What items of income or expense may be presented either in the statement of comprehensive income or in the notes?