**REPORTING WITHIN THE INCOME STATEMENT**

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**1. Gross Profit**

Companies generally provide some detail on revenues and expenses on the face of the income statement, but may prepare a condensed income statement with details presented in the notes to the financial statements. Companies are required to present expenses classified either by their nature (nature-of-expense method) or their function (function-of-expense method). The function-of-expense method is generally used in practice, but then the individual expenses are itemized in the notes to the financial statements.

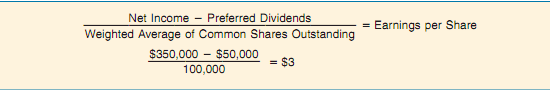
The IASB takes the position that both revenues and expenses and other income and expenses should be reported as part of income from operations. Companies can provide additional line items, headings, and subtotals when such presentation is relevant to an understanding of the entity’s financial performance

**2.Earnings per share**

In general, earnings per share represents the ratio of net income minus preference dividends (income available to common shareholders) divided by the weighted average number of common shares outstanding. It is considered by many financial statement users to be the most significant statistic presented in the financial statements, and must be disclosed on the face of the income statement. Per share amounts for gain or loss on discontinued operations must be disclosed on the face of the income statement or in the notes to the financial statements.

The results of a company’s operations are customarily summed up in one important figure: net income. As if this condensation were not enough of a simplification, the financial world has widely accepted an even more distilled and compact figure as its most significant business indicator—earnings per share (EPS).

The computation of earnings per share is usually straightforward. Net income minus preferred dividends (income available to common stockholders) is divided by the weighted average of common shares outstanding to arrive at earnings per share. To illustrate, assume that Lancer, Inc. reports net income of $350,000 and declares and pays preferred dividends of $50,000 for the year. The weighted average number of common shares outstanding during the year is 100,000 shares. Earnings per share is $3, as computed in Illustration below:



Note that the EPS figure measures the number of dollars earned by each share of common stock—not the dollar amount paid to stockholders in the form of dividends

“Net income per share” or “earnings per share” is a ratio commonly used in prospectuses, proxy material, and annual reports to stockholders. It is also highlighted in the financial press, by statistical services like Standard & Poor ’s, and by Wall Street securities analysts. Because of its importance, earnings per share is required to be dis- closed on the face of the income statement. A company that reports a discontinued operation, an extraordinary item, or the cumulative effect of a change in accounting principle must report per share amounts for these line items either on the face of the income statement or in the notes to the financial statement

3. **OTHER REPORTING ISSUES**

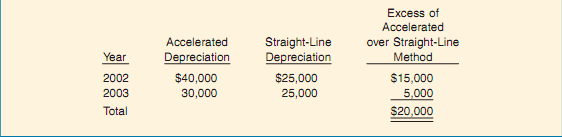
**Accounting changes and Errors**

**Change in Accounting principle**

Changes in accounting occur frequently in practice, because important events or con- ditions may be in dispute or uncertain at the statement date. One type of accounting change, therefore, comprises the normal recurring corrections and adjustments that are made by every business enterprise. Another accounting change results when an accounting principle is adopted that is different from the one previously used. Changes in accounting principle would include a change in the method of inventory pricing from FIFO to average cost or a change in depreciation from the double-declining to the straight-line method.

Changes in accounting principle are recognized by including the cumulative effect as of the beginning of the year, net of tax in the current year ’s income statement. This amount is based on a retroactive computation of changing to a new accounting prin- ciple. The effect on net income of adopting the new accounting principle should be disclosed as a separate item following extraordinary items in the income statement.

To illustrate, Gaubert Inc. decided in March 2004 to change from an accelerated method of computing depreciation on its plant assets to the straight-line method. The assets originally cost $100,000 in 2002 and have a service life of four years. The data assumed for this illustration are as shown in Illustration below:

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*Calculation of a Change in Accounting Principle*

**Changes in estimates**

Estimates are inherent in the accounting process. Estimates are made, for example, of useful lives and salvage values of depreciable assets, of uncollectible receivables, of inventory obsolescence, and of the number of periods expected to benefit from a par- ticular expenditure. Not infrequently, as time passes, as circumstances change, or as additional information is obtained, even estimates originally made in good faith must be changed. Such changes in estimates are accounted for in the period of change if they affect only that period, or in the period of change and future periods if the change affects both.

To illustrate a change in estimate that affects only the period of change, assume that DuPage Materials Corp. has consistently estimated its bad debt expense at 1 per- cent of credit sales. In 2003, however, DuPage’s controller determines that the estimate of bad debts for the current year ’s credit sales must be revised upward to 2 percent, or double the prior years’ percentage. Using 2 percent results in a bad debt charge of $240,000, or double the amount using the 1 percent estimate for prior years. The 2 per- cent rate is necessary to reduce accounts receivable to net realizable value. The provision is recorded at December 31, 2003, as follows:

Bad Debt Expense $240,000

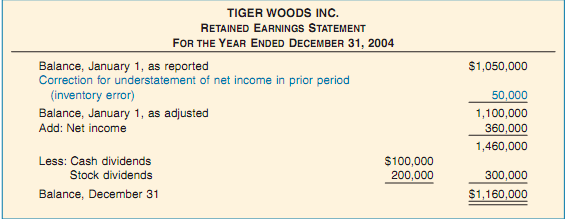
Allowance for doubtful account $240,000

The entire change in estimate is included in 2003 income because no future periods are affected by the change. Changes in estimate are not handled retroactively. That is, they are not carried back to adjust prior years. Changes in estimate are not considered errors (prior period adjustments) or extraordinary items

**Retained earnings statement**

Net income increases retained earnings, and a net loss decreases retained earnings. Both cash and stock dividends decrease retained earnings. Prior period adjustments may ei- ther increase or decrease retained earnings. A prior period adjustment is a correction of an error in the financial statements of a prior period. Prior period adjustments (net of tax) are charged or credited to the opening balance of retained earnings, and thus excluded from the determination of net income for the current period

Information related to retained earnings may be shown in different ways. For example, some companies prepare a separate retained earnings statement, as shown in Illustration below:

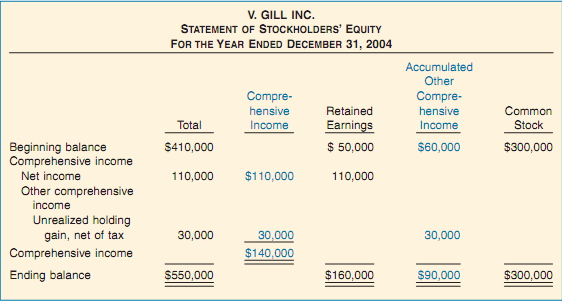
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The reconciliation of the beginning to the ending balance in retained earnings pro- vides information about why net assets increased or decreased during the year. The association of dividend distributions with net income for the period indicates what 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 year

**Statement of changes in Equity**

This statement reports the changes in each stockholder ’s equity account and in total stockholders’ equity during the year. The statement of stockholders’ equity is often prepared in columnar form with columns for each account and for total stock- holders’ equity.

To illustrate its presentation, assume the same information related to V. Gill Inc. and that the company had the following stockholder equity account balances at the beginning of 2004: Common Stock $300,000; Retained Earnings $50,000; and Accumulated Other Comprehensive Income $60,000. No changes in the Common Stock account oc- curred during the year. A statement of stockholders’ equity for V. Gill Inc. is shown in Illustration below:



Most companies use the statement of stockholders’ equity approach to provide information related to the components of other comprehensive income. Because many companies already provide a statement of stockholders’ equity, adding additional columns to display information related to comprehensive income is not costly