Corporate reporting income
Earnings per share
Retained earnings

Objectives

Explain the form and content of a comprehensive corporate income statement

Describe and account for share dividends, share splits and retirement of shares.

Compute earnings per share and describe its use.

Explain the items reported in retained earnings.

The basic corporate income statement shows the revenues, expenses, and income generated by the company's continuing operations.

Amanda Corporation
Income Statement
For Year Ended December 31, 2001

Sales		$100
Cost of goods sold		40
Gross profit		$ 60
Operating expenses		18
Income from operations		$ 42
Other revenues and expenses:[1]		
Gain on sale of capital assets	$4	
Interest revenue	3	
Loss on sale of capital assets	(7)	
Interest expense	(2)	(2)
Income before tax		$ 40
Income tax expense		10
Net income		$ 30

Continuing operations

When a company's activities include income-related events that are not part of a company's continuing, normal operations, the income statements needs to be expanded to include different sections to provide more useful information to users.

CanComp
Income Statement
For Year Ended December 31, 2001

Net sales		$8,440,000	Inc
Cost of goods sold		5,950,000	fc
Gross profit		$2,490,000	
Operating expenses		570,000	
Operating income		$1,920,000	
Other revenues and expenses:			
Loss on relocating a plant	$ (45,000)		① Continuing operations
Gain on sale of land	72,000	27,000	
Income from continuing operations before income tax		$1,947,000	
Income tax expense		397,000	
Income from continuing operations		$1,550,000	
Discontinued operations:			
Income from operating Division A (net of $ 180,000 income taxes)	$420,000		② Discontinued operations
Loss on disposal of Division A net of $66,000 tax benefit)	(154,000)	266,000	
Income before extraordinary items		$1,816,000	
Extraordinary items:			
Gain on sale of land taken by government (net of $61,200 income taxes)	$142,000		③ Extraordinary items
Loss from earthquake damage (net of $270,000 income tax benefit)	(630,000)	(488,000)	
Net income		$1,328,000	
Earnings per common share (200,000 outstanding shares):			
Income from continuing operations		$ 7.75	
Income from discontinued operations		1.33	④ Earnings per share
Income before extraordinary items		$ 9.08	
Extraordinary items		(2.44)	
Net income (basic earnings per share)		$ 6.64	

Discontinued operations

1. the gain or loss from selling or closing down a segment, and
2. the income from operating the discontinued segment prior to its disposal.

Extraordinary items

The CICA handbook identifies extraordinary gains and losses as items that have all of the following three characteristics:

- They are not expected to occur frequently over several years.
- They do not typify the normal business activities of the entity, and
- They do not depend primarily on decisions or determinations by management or owners.

The list of items usually considered extraordinary include:

- Expropriation of property
- Condemning of property
- Prohibition against using an asset
- Losses or gains from an unusual and infrequent calamity.

Examples of items not considered extraordinary:

- Write-downs of inventories
- Write-offs of receivables
- Gains or losses from exchanging foreign currencies.
- Effects of labour strikes
- Accrual adjustments on long-term contracts
- Sale of equipment.

Additional share transactions

Share dividends

Share dividend = stock dividend: where a company distributes additional shares to its shareholders without receiving any payment in return.

Reasons for share dividends

1 Directors are said to use share dividends to keep the market price of the shares affordable. For example, if a profitable corporation grows but does not pay cash dividends, the price of its common shares continues to increase. The price of such a share may become so high that it discourages some investors from buying them. When a corporation declares a share dividend, it increases the number of outstanding shares and lowers the per share price of its shares.

2 Issuing share dividends conserves cash for business expansion that will hopefully lead to positive returns on shareholder investment.

3 A share dividend provides evidence of management's confidence that the company is doing well.

X-Quest
Shareholders' Equity
December 31, 2001

Contributed capital:	
Common shares, 15,000 shares authorized, 10,000 shares issued and outstanding	$108,000
Retained earnings	35,000
Total shareholders' equity	$143,000

Dec. 31	Retained earnings Common shares dividends distributable	15 000	15 000
	To record declaration of a share dividend of 1 000 common shares		

X-Quest Ltd.
Shareholders' Equity
December 31, 2001

Contributed capital:	
Common shares, 15,000 shares authorized, 10,000 shares issued and outstanding	$108,000
Common shares dividend distributable, 1,000 shares	15,000
Total contributed capital	$123,000
Retained earnings	20,000
Total shareholders' equity	$143,000

Share splits

A share split is the distribution of additional shares to shareholders according to their percent ownership.

Splits can be done in any ratio including two-for-one, three-for-one, or higher.

CLT Inc.
Shareholders' Equity

	Dec. 31, 2001 Before Share Split	Jan. 20, 2002 After Share Split
Contributed capital:		
Common shares, 100,000 shares authorized,		
Dec. 31, 2001: 20,000 shares issued and outstanding	$240,000	
Jan. 4, 2002: 60,000 shares issued and outstanding		$240,000
Retained earnings	90,000	90,000
Total shareholders' equity	$330,000	$330,000

Repurchase of shares

Shares can be repurchased and then retired;

Retiring shares

May 1	Common shares Cash Purchased and retired 1 000 common shares equal to the average issue price: $12 x 1 000 shares	12 000	 12 000

i.e.

June 1	Common shares Cash Contributed capital from retirement of common shares Purchased and retired 500 common shares at less than the average issue price: $12 x 500 shares = $ 6 000; $11 x 500 shares = $5,500	6000	 5 500 500

Demonstration problem

Airies Travel Inc. showed the following at August 31, 2002:

Airies Travel Inc.
Shareholders' Equity
August 31, 2002

Contributed capital:	
Common shares, 100,000 shares authorized, 10,000 shares issued and outstanding*	$150,000
Retained earnings	80,000
Total shareholders' equity	$230,000

*All of the common shares had been issued for an average price of $15.00 per share calculated as $150,000 ÷ 10,000 shares.

Part 1

On September 3, 2002, Airies' Board of Directors declared a 20% share dividend to shareholders of record on September 17 to be distributed on September 24. The share prices on each of these dates was:

Date	Market price per share
Sept. 3, 2002	$15.20
17, 2002	15.25
24, 2002	12.30

Several months later, the board declared a two-for-one share split effective June 12, 2003.

Required

a. Prepare the journal entries, if applicable, for September 3, 17, and 24, along with June 12.
b. Prepare a comparative shareholders' equity section immediately before and after the share dividend, similar to Exhibit 16.5. Assume no other changes to retained earnings.
c. Prepare a comparative shareholders' equity section immediately before and after the share split, similar to Exhibit 16.6.

Part 2

Required

Assuming the information for Airies Travel Inc. only at August 31, 2002, record the following entries:

a. On September 16, 2002, Airies Travel repurchased and retired 500 of its common shares paying $15.00 per share.
b. Airies repurchased and retired 1,000 of its shares on November 5, 2002, paying $14.50 per share.
c. Airies paid $16.20 per share on July 14, 2003, to repurchase and retire 1,000 of its shares.

Solution Part 1

2002			
Sept. 3	Share Dividends Declared.............................	30,400	
	Common Shares Dividend Distributable.		30,400
	Declared a 20% share dividend; *10,000 × 20% = 2,000 shares;* *2,000 shares × $15.20/share = 30,400.*		
17	No entry.		
24	Common Shares Dividend Distributable........	30,400	
	Common Shares		30,400
	Distributed 2,000 shares regarding the share dividend declared on September 3.		
2003			
June 12	No entry.		
	Note disclosure is required stating that an additional 12,000 shares are to be distributed as a result of the two-for-one share split.		

b.

Airies Travel Inc.
Shareholders' Equity

	Before Share Dividend	After Share Dividend
Contributed capital:		
Common shares, 100,000 shares authorized,		
Before share dividend: 10,000 shares issued and outstanding.	$150,000	
After share dividend: 12,000 shares issued and outstanding		$180,400
Retained earnings..	80,000	49,600
Total shareholders' equity.......................................	$230,000	$230,000

Part II

Airies Travel Inc. Shareholders' Equity	Before Share Split	After Share Split
Contributed capital:		
Common shares, 100,000 shares authorized,		
Before share dividend: 10,000 shares issued and outstanding.	$180,400	
After share dividend: 12,000 shares issued and outstanding		$180,400
Retained earnings	49,600	49,600
Total shareholders' equity	$230,000	$230,000

Part 2

a.	2002			
	Sept. 16	Common Shares	7,500	
		Cash		7,500
		To record repurchase of common shares; 500 × $15.00 = $7,500		
b.	Nov. 5	Common Shares	15,000	
		Contributed Capital from Retirement of Common Shares		500
		Cash		14,500
		To record repurchase of common shares; 1,000 × $14.50 = $14,500; 1,000 × ($15.00 − $14.50) = $500.		
c.	2003			
	July 14	Common Shares	15,000	
		Contributed Capital from Retirement of of Common Shares	500	
		Retained Earnings	700	
		Cash		16,200
		To record repurchase of common shares; 1,000 × $16.20 = $16,200; 1,000 × ($16.20 − $15.00) = $1,200.		

Earnings per share

Earnings per share, also called net income per share, is the amount of income earned by each share of a company's outstanding common shares.

$$\text{earnings per share} = \frac{\text{net income} - \text{preferred dividends}}{\text{weighted-average common shares}}$$

When there is no change in common shares outstanding

Lescon Inc.
Shareholders' Equity
December 31, 2001

Contributed capital:	
Common shares, unlimited shares authorized,	
500,000 shares issued and outstanding	$6,500,000
Retained earnings	480,000
Total shareholders' equity	$6,980,000

Exhibit 16.9 illustrates the earnings per share presentation for Lescon Inc. for the year ended December 31, 2001, calculated as $750,000/500,000 shares = $1.50.

Lescon Inc.
Income Statement
For Year Ended December 31, 2001

Sales	$8,500,000
Cost of goods sold	4,600,000
Net income	$ 750,000
Earnings per common share	$1.50

When there are changes in common shares outstanding.

The number of shares outstanding can change because of :

- The issuance of additional shares
- Share dividends
- Share splits, and/or
- Retirement of shares

When shares are sold or purchased in the period

Lescon Inc.
Shareholders' Equity
December 31, 2002

Contributed capital:	
Preferred shares, $5 cumulative, unlimited shares authorized,	
50,000 shares issued and outstanding	$1,000,000
Common shares, unlimited shares authorized,	
540,000 shares issued and 510,000 shares outstanding*	7,200,000
Total contributed capital	$8,200,000
Retained earnings	1,110,000
Total shareholders' equity	$9,310,000

*40,000 common shares were issued on April 1, 2002
30,000 common shares were repurchased and retired on November 1, 2002

Time Period	Outstanding Shares	Fraction of Year Outstanding	Weighted average
January–March	500,000	× 3/12	= 125,000
April–October	540,000	× 7/12	= 315,000
November–December	510,000	× 2/12	= 85,000
Weighted average outstanding shares			525,000

We can then compute Lescon's basic earnings per share for the year ended December 31, 2002 as:

$$\text{Basic earnings per share} = \frac{\$880{,}000 \text{ net income} - \$250{,}000 \text{ preferred dividends declared*}}{525{,}000} = \underline{\underline{\$1.20}}$$

*Note: Because the preferred shares are cumulative, the annual dividends of $250,000 would be subtracted even if the dividends had not been declared.

When shares are split during the period

Computing Weighted-Average Number of Shares Outstanding with Share Split

Time Period	Outstanding Shares	Effect of Split	Fraction of Year	Weighted average
January–March	500,000	× 2	× 3/12	= 250,000
April–October	540,000	× 2	× 7/12	= 630,000
November	510,000	× 2	× 1/12	= 85,000
December	1,020,000	× 1	× 1/12	= 85,000
Weighted average outstanding shares				1,050,000

Lescon's basic earnings per share for the year 2002 under the assumption of the two-for-one share split is:

$$\text{Basic earnings per share} = \frac{\$880{,}000 \text{ net income} - \$250{,}000 \text{ preferred dividends declared}}{1{,}050{,}000}$$

$$= \$0.60$$

When a share dividend is paid

Computing Weighted-Average Number of Shares with Share Dividend

Time Period	Outstanding Shares	Effect of Share Dividend	Fraction of Year	Weighted average
January–March	500,000	× 1.10	× 3/12	= 137,500
April–October	540,000	× 1.10	× 7/12	= 346,500
November	510,000	× 1.10	× 1/12	= 46,750
December	561,000	× 1	× 1/12	= 46,750
Weighted-average outstanding shares				577,500

Earnings per share under the assumption of the 10% stock dividend would be:

$$\text{Basic earnings per share} = \frac{\$880{,}000 \text{ net income} - \$250{,}000 \text{ preferred dividends declared}}{577{,}500}$$

$$= \$1.09^{*}$$

rounded to 2 decimal places

Problem

X-On Ltd. began 2001 with the following balances in its shareholders' equity accounts:

Common shares, 800,000 shares authorized, issued and outstanding	$3,000,000
Retained earnings	2,500,000
Total shareholders' equity	$5,500,000

The following share-related transactions occurred during the year:

Date	Transaction
March 1	Issued at $20 per share 100,000 $2.50 cumulative preferred shares with an unauthorized limit.
May 1	Issued 50,000 common shares at $15 per share.
Sept. 1	Repurchased 150,000 common shares at $16 per share.
Nov. 30	Declared and distributed a 3:1 share split on the common shares.

Required

- Calculate the weighted average number of shares outstanding using the information above.
- Using the information provided, prepare an income statement for 2001 similar to Exhibit 16.2:

Cumulative effect of a change in amortization method (net of $26,000 tax benefit)	$ (136,500)
Expenses (related to continuing operations)	(2,072,500)
Extraordinary gain on expropriated land (net of $71,000 tax expense)	275,500
Gain on disposal of discontinued operation's assets (net of $8,600 tax expense)	37,500
Gain on sale of investment in shares	400,000
Loss from operating discontinued operations (net of $40,000 tax benefit)	(182,500)
Income taxes on income from continuing operations	(660,000)
Sales	5,375,000
Loss from sale of plant assets*	(650,000)

*The assets were items of equipment replaced with new technology.

SOLUTION TO Demonstration Problem

Compute the weighted-average number of outstanding shares:

Time Period	Outstanding Shares	Effect of Split	Fraction of Year	Weighted average
January–April	500,000	× 3	× 4/12	= 500,000
May–August	550,000	× 3	× 4/12	= 550,000
September–November	400,000	× 3	× 3/12	= 300,000
December	1,200,000	× 1	× 1/12	= 100,000
Weighted average outstanding shares				1,450,000

. Prepare an income statement for 2001:

X-On Ltd.
Income Statement
For Year Ended December 31, 2001

Sales		$5,375,000
Expenses		2,072,500
Income before tax		$3,302,500
Income tax expense		660,000
Income from operations		$2,642,500
Other revenues and expenses:		
Gain on sale of investment in shares	$ 400,000	
Loss from sale of plant assets	(650,000)	(250,000)
Income from continuing operations		$2,392,500
Discontinued operations:		
Loss from operating discontinued operation (net of $40,000 tax benefit)	$(182,500)	
Gain on disposal of discontinued operation's assets (net of $8,600 tax)	37,500	(145,000)
Income before extraordinary items		$2,247,500
Extraordinary items:		
Extraordinary gain on expropriated land (net of $71,000 tax)		275,500
Net income		$2,523,000
Earnings per share (1,450,000 average shares outstanding):		
Income from continuing operations		$1.65[1]
Loss from discontinued segment		(0.10)[2]
Income before extraordinary gain		$1.55
Extraordinary gain		0.19[3]
Net income		$1.74

[1] $2,392,500/1,450,000 = $ 1.65
[2] $(145,000)/1,450,000 = $(0.10)
[3] $275,500/1,450,000 = $ 0.19