

**Case 09-8**  
**Classified Information**

Lads and Lassies (L&L), an SEC registrant, has its year end on the Saturday closest to January 31. Fiscal 2006, 2005, and 2004, which include 52 weeks each, ended on January 28, 2006, January 29, 2005, and January 31, 2004, respectively.

L&L manufactures and sells exclusive children's clothing to the most discerning clientele. Its products offer high quality and modern style, including everything from a colorful collection of cashmere sweaters to perfect vintage washed tees. The products are sold through its boutiques, each of which resembles a New England seaside cottage.

The boutiques also include the Sassy Spa for Spoiled Pip-Squeaks (Sassy Spa), which was introduced in the third quarter of fiscal 2005. These spas for children offer hair and nail care, make-up application, massage services, and even etiquette classes.

L&L has the following information that needs to be analyzed to determine the appropriate income statement presentation.

**1. Net Sales**

L&L had net sales of \$74.5 million in fiscal 2005 and \$86.5 million in fiscal 2006; an increase of \$12 million, or 16.1 percent. The increase in net sales was driven, in part, by an increase in revenue from services provided by Sassy Spa, which increased from \$3.9 million in fiscal 2005 to \$11.2 million in fiscal 2006. The remaining increase in total net sales of \$4.7 million was because of an increase in the average transaction value, driven by higher average retail sales on a per unit basis due to the favorable customer response to the use of more vintage prints in its garments.

**2. Gross Profit**

Gross profit, which represents net sales less cost of sales, increased from \$28 million in fiscal 2005 to \$30.4 million in fiscal 2006; an increase of \$2.4 million, or 8.6 percent.

Cost of sales includes expenses incurred to acquire and produce inventory for sale, such as product costs, freight-in and import costs, and direct labor costs for Sassy Spa employees. However, cost of sales excludes depreciation. Cost of sales increased from \$46.5 million in fiscal 2005 to \$56.1 million in fiscal 2006; an increase of \$9.6 million, or 20.6 percent, primarily as the result of an increase in the cost of Sassy Spa services.

**3. Gain on Sale of Corporate Headquarters**

L&L relocated its corporate headquarters to Wilton, Connecticut. In connection with the relocation, L&L sold the abandoned building and realized a gain of \$1.7 million on the sale.

**4. Class Action Settlement**

L&L became aware that the “vintage” materials provided by one of its fabric suppliers were not, in fact, vintage. During fiscal 2006, L&L settled a class action lawsuit related to the legal case against the supplier in connection with this scandal and received proceeds of \$2.7 million.

**Required:**

- Determine the appropriate income statement presentation (sales, cost of sales, gross profit, operating income or expense, non-operating income or expense) for each item noted above. Note that L&L presents a subtotal for operating income on the income statement.