

Reasons Why Fundamental Accounting Concept¹ Test Fails

IS2

Operating Income (Loss) = Gross Profit - Operating Expenses + Other Operating Income (Expenses)
(Multi-step approach)

What this rule tests

This rule tests the relationship between three very common line items of a financial report:

- Gross Profit
- Operating Expenses
- Other Operating Income (Expenses)
- Operating Income (Loss)

This tests the conformance to the relation between gross profit and operating income (loss) when a multi-step approach is taken to representing an income statement.

Of a total 9,679 financial reports examined, 3,621 (approximately 37%) report gross profit and 6,594 (approximately 68%) report operating income (loss). 3,230 (approximately 33%) explicitly report both gross profit and operating income (loss).

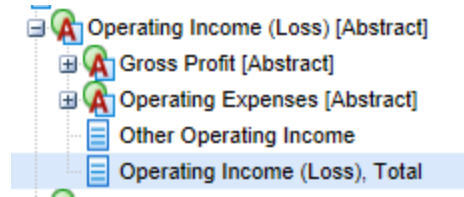
Further, 4,547 (approximately 47%) report operating expense. Far fewer, 153 (approximately 2%) report other operating income (loss). This rule is generally always applicable when a reporting entity provides a multi-step income statement. However, there are times when this relation can be satisfied when a reporting entity does report operating income (loss), cost of revenue so that gross profit can be imputed, operating expenses which are commonly reported, and other operating income (expenses).

Conforming to this relation tends to make all of the fundamental accounting concepts interpretable by automated machine-based processes. It is possible to create a correct digital financial report and not conform to this relation. However, conforming to this test is necessary to safely interpret financial information. The following is a summary of reasons public companies do not conform to this relation:

- Subtotals are not provided for either operating expenses nor other operating income (expense)
- Some other fundamental accounting concept is used as a component of either operating expenses or other operating income (expense)
- Subtotals are provided for either operating expenses or other operating income (expense) but then an extension concept is provided and the category into which the extension fits is unclear
- Other issues

¹ For more information on the fundamental accounting concepts and the relations between these concepts please see <http://fundamentalaccountingconcepts.wikispaces.com>

There are exactly two line items between gross profit and operating income (loss) when a multi-step income statement is provided: operating expenses and other operating income. This can be seen from this relation from the US GAAP XBRL Taxonomy:



These are the XBRL calculation relations expressed in the US GAAP XBRL Taxonomy:

124000 - Statement - Statement of Income (Including Gross Margin)

-								Gross Profit	Cr	
								Operating Expenses	Dr	
+								Other Operating Income (Expense), Net	Cr	
									Operating Income (Loss)	Cr

The income statement of the filing below shows the general relationship between these concepts:

http://www.sec.gov/cgi-bin/viewer?action=view&cik=789019&accession_number=0001193125-14-157088&xbrl_type=v#

Income Statements (USD \$) In Millions, except Per Share data, unless otherwise specified	3 Months Ended		9 Months Ended	
	Mar. 31, 2014	Mar. 31, 2013	Mar. 31, 2014	Mar. 31, 2013
Revenue	\$ 20,403	\$ 20,489	\$ 63,451	\$ 57,953
Cost of revenue	5,941	4,787	19,339	14,647
Gross margin	14,462	15,702	44,112	43,306
Operating expenses:				
Research and development	2,743	2,640	8,258	7,628
Sales and marketing	3,542	3,794	11,129	11,048
General and administrative	1,203	1,656	3,448	3,939
Total operating expenses	7,488	8,090	22,835	22,615
Operating income	6,974	7,612	21,277	20,691
Other income (expense)	(17)	(9)	(34)	216
Income before income taxes	6,957	7,603	21,243	20,907
Provision for income taxes	1,297	1,548	3,781	4,009
Net income	\$ 5,660	\$ 6,055	\$ 17,462	\$ 16,898

Gross margin	14,462	15,702	44,112	
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- Definition
Aggregate revenue less cost of goods and services sold or operating expenses directly attributable to the revenue generation activity.

+ References

- Details

Name: us-gaap_GrossProfit

Namespace Prefix: us-gaap_

Data Type: xbrl:monetaryItemType

Total operating expenses	7,488	8,090	22,835
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- Definition
Generally recurring costs associated with normal operations except for the portion of these expenses which can be clearly related to production and included in cost of sales or services. Includes selling, general and administrative expense.

+ References
- Details
Name: us-gAAP_OperatingExpenses
Namespace Prefix: us-gAAP_
Data Type: xbrli:monetaryItemType
Balance Type: debit

Operating income	6,974	7,612	21,277
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- Definition
The net result for the period of deducting operating expenses from operating revenues.

+ References
- Details
Name: us-gAAP_OperatingIncomeLoss
Namespace Prefix: us-gAAP_
Data Type: xbrli:monetaryItemType

Note that the reporting entity has no line item which represents “Other operating income”. They do have a line item “Other income (expense)” but note that (a) the concept is not within the total of operating income (loss) and (b) the line item is represented by the concept *us-gAAP:NonoperatingIncomeExpense* and is therefore clearly nonoperating.

Other income (expense)	(17)	(9)	(34)
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- Definition
The aggregate amount of income or expense from ancillary business-related activities (that is to say, excluding major activities considered part of the normal operations of the business).

+ References
- Details
Name: us-gAAP_NonoperatingIncomeExpense
Namespace Prefix: us-gAAP_
Data Type: xbrli:monetaryItemType

Reasons why tests fail

Subtotals are not provided for either operating expenses nor other operating income (expense)

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Some other fundamental accounting concept is used as a component of either operating expenses or other operating income (expense)

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Subtotals are provided for either operating expenses or other operating income (expense) but then an extension concept is provided and the category into which the extension fits is unclear

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