Public Roundtable on the Implementation of the Accounting Standards Update on Disaggregation of Income Statement Expenses

Wednesday May 27, 2026
1:30 p.m.–3:30 p.m.

Financial Accounting Standards Board
801 Main Avenue
Norwalk, Connecticut

Project Background and Objective of the Roundtable

1. The purpose of this roundtable is to help the Board and staff gather feedback from investors, preparers, practitioners, and other stakeholders as part of the implementation efforts of Accounting Standards Update No. 2024-03, *Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*. The discussion is intended to help the Board and staff better understand how entities are progressing in their implementation of the amendments in practice and identify any possible areas where further clarification may be needed. Additionally, this discussion is intended to help the Board and staff better understand what additional information investors need as they prepare to use the information provided by Update 2024-03.

2. The Board issued Update 2024-03 to improve the disclosures about a public business entity's expenses and address requests from investors for more detailed information about the types of expenses (including purchases of inventory, employee compensation, depreciation, amortization, and depletion) in commonly presented expense captions (such as cost of sales; selling, general, and administrative (SG&A); and research and development (R&D)).

3. The amendments in Update 2024-03 apply to all public business entities. The amendments do not change or remove presentation requirements for public business entities subject to the SEC's presentation requirements under Regulation S-X Rule 210, Form and Content of and Requirements for Financial Statements, or any other existing presentation requirements.

4. The amendments in Update 2024-03 are effective for public business entities for annual reporting periods beginning after December 15, 2026, and interim reporting periods within annual reporting

periods beginning after December 15, 2027.[1] Early adoption is permitted. The amendments in Update 2024-03 should be applied either (a) prospectively to the financial statements issued for the reporting periods beginning after the effective date or (b) retrospectively to any or all prior periods presented in the financial statements.

5. These materials are organized as follows:
   a. Topic 1: Overall
   b. Topic 2: Relevant Expense Captions and Required Expense Categories
   c. Topic 3: Integration of Existing Disclosures and Qualitative Description of Other Items, Other Enhancements to the Disaggregation Requirements, and Selling Expenses
   d. Appendix A: Summarized History of the DISE Project
   e. Appendix B: Tabular Integration of Other Disclosure Requirements
   f. Appendix C: Illustrative Examples.

6. Discussion questions are included at the end of each Topic and a consolidated list of those questions is included here.

Consolidated List of Questions for Participants

Topic 1: Overall

1. Investors, do you require any additional information from the FASB to facilitate your understanding of the new disclosures?
2. What is the status of your entity's (or your clients') implementation efforts? What are your observations about the implementation process thus far?
3. To what extent are your entity's (or your clients') disaggregated expense amounts required by Update 2024-03 determined using transaction-level accounting records versus estimation or allocation techniques (as contemplated in paragraph 220-40-50-1)? Does your approach vary by expense category? As part of your estimation process, is your entity's (or your clients') starting point the total amount of the required expense category (for example, total compensation), and do you find it operable to determine those total amounts? Have you identified any obstacles to using an estimation approach?
4. The materiality guidance in paragraph 105-10-05-6 applies to the amendments in Update 2024-03. In applying the guidance to identify relevant expense captions and disaggregating

[1] Accounting Standards Update No. 2025-01, *Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40): Clarifying the Effective Date*, was issued to provide a minor clarification to the effective date in Update 2024-03.

Consolidated List of Questions for Participants

those captions into the required categories, are there unique challenges in applying the materiality guidance?

5. Is any additional guidance needed from the FASB or other parties to facilitate the adoption of Update 2024-03?

Topic 2: Relevant Expense Captions and Required Expense Categories

6. The amendments in the Update require that an entity identify relevant expense captions on the income statement that would be subject to disaggregation in the notes to financial statements. In your experience thus far, is the identification of relevant expense captions operable? Do you expect that approach to present any challenges?
7. The amendments in the Update require that an entity disclose the amounts of the required expense categories (purchases of inventory; employee compensation; depreciation; intangible asset amortization; and depreciation, depletion, and amortization recognized as part of oil-and gas-producing activities (DD&A)) included in each relevant expense caption. In your experience thus far, are the required expense categories clearly defined and operable to apply?
8. If your entity has inventory within the scope of Topic 330, Inventory, do you intend to use the cost-incurred or expense-incurred approach? Are there any specific system or process constraints that factored into that decision?

Topic 3: Integration of Existing Disclosure and Qualitative Description of Other Items, Other Enhancements to the Disaggregation Requirements, and Selling Expenses

9. For the integration of existing disclosure requirements (paragraph 220-40-50-21 or 220-40-50-22), do you expect those amounts to reduce “other items” in your tabular disclosures in a meaningful way?
10. Do you think complying with the requirement to qualitatively describe “other items” necessitates a detailed breakdown of all remaining expense amounts, or do you think entities can instead apply judgment to describe what remains?
11. Does any of the guidance outlined in paragraph 39 of these materials apply to your entity (or your clients)? Do you expect that those provisions will make implementation and application of the guidance more straightforward or are there additional questions?

Topic 1: Overall

7. The purpose of Topic 1 is to discuss the expected benefits of the Update and obtain feedback from roundtable participants on the status of implementation efforts and how entities are expecting to apply the guidance.

Benefits

8. The Board expects that nearly all public business entities will disclose more information under the amendments in Update 2024-03 about the components of those expense captions than is currently disclosed in financial statements. That incremental information will allow investors to better understand the components of an entity's expenses, make their own judgments about the entity's performance, and more accurately forecast expenses, which in turn should enable investors to better assess an entity's prospects for future cash flows. It also will provide contextual information for an entity's preparation and an investor's consideration of management's discussion and analysis of financial position and results of operations (MD&A).

9. The main benefits of the amendments in Update 2024-03 are as follows (see paragraph BC25):

   a. *Required expense categories.* Disclosing the purchases of inventory; employee compensation; depreciation; intangible asset amortization; and depreciation, depletion, and amortization recognized as part of oil and gas-producing activities (DD&A) (or other amounts of depletion expense) expense categories provides transparency about the components of expense captions and enhances an investor's ability to forecast future performance because those expense categories are expected to respond differently to changes in economic conditions. Investors also will have more comparable information between entities because the composition of expenses included in the categories is more consistent than that of expense captions such as cost of sales or SG&A.

   b. *Disaggregation of existing disclosure requirements in a single disclosure note.* Including certain expenses required to be disclosed under current GAAP in the same tabular format disclosure improves the transparency of the components of income statement expense captions by reducing the cost and effort required of investors to identify and locate the related information.

   c. *Qualitative disclosures about residual amounts.* Disclosing qualitative information about amounts that have not been disaggregated and remain in relevant expense captions after disclosing the expense amounts listed in paragraph 9(a) and (b) of these materials provides incremental information about the composition of those expense captions beyond what is currently provided.

   d. *Selling expenses disclosure.* Disclosing selling expenses and how they are determined is expected to enhance an investor's understanding of what management determines to be selling expenses as well as provides insights into costs that are likely to vary based on changes in revenue. Investors communicated that they would prefer to forecast selling expenses separately from general and administrative expenses.

e. *Interim and annual reporting requirements.* Requiring the disclosures for interim and annual reporting periods provides investors with more timely and useful information. Additionally, requiring interim disclosures will allow investors to update their expectations for an entity's major individual expense captions throughout the year, rather than only when annual financial statements are issued.

10. The extent of incremental information reported under the amendments in Update 2024-03 may vary across entities. However, it is expected that nearly all entities will disclose significantly more information about the natural components of the expense captions following the implementation of the Update. As a result, this incremental information will allow investors to better understand the components of an entity's expenses, make their own judgments about the entity's performance, and more accurately forecast expenses, which in turn should allow investors to better assess an entity's prospects for future cash flows.

Materiality and Estimates

11. Stakeholder feedback received on the 2023 proposed Accounting Standards Update, *Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*, requested that the Board clarify whether and how to apply the materiality guidance in Topic 105, Generally Accepted Accounting Principles, to the amendments in Update 2024-03. The Board observed that the guidance in paragraph 105-10-05-6, which states that "the provisions of the Codification need not be applied to immaterial items," is applicable to the amendments in the Update and to all Codification guidance. Therefore, the amendments on the disaggregation of relevant expense captions into required expense categories and other disclosures do not apply to immaterial items. For example, if an entity concludes that an immaterial amount of its cost of sales is attributed to depreciation, the Board does not expect that the amendments in the Update will affect that conclusion.

12. In finalizing the amendments in Update 2024-03, the Board made several decisions to mitigate implementation costs and improve operability. Stakeholders noted that entities commonly use estimates, conventions, and judgments—together with materiality assessments—when complying with GAAP. Accordingly, they asked the Board to clarify in the final Update that using estimates or other methods of approximation is appropriate. Entities generally noted this would help them avoid significant changes to their information systems.

13. In response to this feedback, the Board decided to specifically permit the use of estimates or other methods of approximation. The amendments in paragraph 220-40-50-1 state that an entity may use estimates or other methods that produce a reasonable approximation of the amounts required to be

disclosed. This point was clarified in the final Update to alleviate broad concerns about potential reporting system and process limitations in preparing the disclosures and ultimately will reduce costs. Paragraph 220-40-50-1 states the following:

> **220-40-50-1** The objective of the disclosure requirements in this Section is to provide disaggregated information about a public business entity's expenses to help investors:
>
> a. Better understand the entity's performance
> b. Better assess the entity's prospects for future cash flows
> c. Compare an entity's performance over time and with that of other entities.
>
> In addition, the disclosure requirements are intended to provide information about the relative proportion and trends of each category of expense identified in paragraph 220-40-50-6 in relation to the corresponding income statement expense caption amount in order to meet the overall objective described above. An entity shall consider the level of detail necessary to satisfy the disclosure objective and specific requirements of this Subtopic. An entity may use estimates or other methods that produce a reasonable approximation of the amounts required to be disclosed by this Subtopic.

14. The Board did not intend for an entity that uses estimates or other methods of approximation in accordance with paragraph 220-40-50-1 to have to prove the accuracy of those estimates by comparing them to actual transaction level details. See Appendix C for examples showing how an entity might use estimates or other methods of approximation.

Implementation Status

15. A majority of respondents to the proposed Update highlighted the importance of providing sufficient time to implement the disclosure requirements and indicated that a minimum of 36 months would be sufficient. Additionally, a few respondents suggested that the Board consider other regulatory rulemaking when determining an effective date for the disclosure requirements. The Board decided that the amendments in this Update are effective for public business entities for annual reporting periods beginning after December 15, 2026, and interim reporting periods within annual reporting periods beginning after December 15, 2027. In deciding on the effective date, the Board determined that requiring initial adoption in an annual reporting period will provide investors with the most useful information because it represents a full operating cycle and is a baseline from which to compare future interim period information. The Board also decided that an entity is required to apply the amendments prospectively because retrospective transition could be costly and necessitate a later effective date than would be feasible if the amendments could be applied prospectively.

Questions for Participants
1. Investors, do you require any additional information from the FASB to facilitate your understanding of the new disclosures?

Questions for Participants
2. What is the status of your entity's (or your clients') implementation efforts? What are your observations about the implementation process thus far? 3. To what extent are your entity's (or your clients') disaggregated expense amounts required by Update 2024-03 determined using transaction-level accounting records versus estimation or allocation techniques (as contemplated in paragraph 220-40-50-1)? Does your approach vary by expense category? As part of your estimation process, is your entity's (or your clients') starting point the total amount of the required expense category (for example, total compensation), and do you find it operable to determine those total amounts? Have you identified any obstacles to using an estimation approach? 4. The materiality guidance in paragraph 105-10-05-6 applies to the amendments in Update 2024-03. In applying the guidance to identify relevant expense captions and disaggregating those captions into the required categories, are there unique challenges in applying the materiality guidance? 5. Is any additional guidance needed from the FASB or other parties to facilitate the adoption of Update 2024-03?

Topic 2: Relevant Expense Captions and Required Expense Categories

16. The purpose of Topic 2 is to summarize the guidance for relevant expense captions and required expense categories, as well as to give additional background about how the Board arrived at its decisions.

Background Information

17. The amendments in Update 2024-03 require that an entity identify which expense captions presented on the face of the income statement are relevant expense captions and then disaggregate the relevant expense captions in a tabular format disclosure in the notes to financial statements. For the purposes of the amendments in Update 2024-03, an expense caption is relevant if it contains at least one of the following types of expenses: (a) purchases of inventory, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, or (e) DD&A (or other amounts of depletion expense).

18. When determining which expense captions should be subject to the disaggregation requirements, the Board decided to focus on the substance of the expenses that are included in a given expense caption rather than the current presentation guidance or the title of the caption presented. Accordingly, the Board established requirements that are flexible and can be applied by public business entities in

various industries by requiring that an expense caption is a relevant expense caption if it contains any of the required expense categories. Common examples of relevant expense captions are cost of sales, SG&A, and R&D expenses (or similarly named expenses). Relevant expense captions will vary by entity and industry.

19. The Board's decision to require the disaggregation of relevant expense captions into specific categories was the result of four main considerations: (a) the required categories are types of natural expenses, (b) a finite number of specified categories would be required (as opposed to a requirement to disaggregate expenses fully by nature), (c) the required categories align with investor feedback about the highest priority natural expenses, and (d) it is similar to the approach taken by the International Accounting Standards Board (IASB) in its project on primary financial statements, which resulted in the IASB issuing IFRS 18, *Presentation and Disclosure in Financial Statements*.

Disaggregation Approach

20. A relevant expense caption is an expense caption presented on the face of the income statement in continuing operations that contains any of the expenses discussed previously in paragraph 17 of these materials. A relevant expense caption that comprises entirely one required expense category is not subject to the disaggregation requirements. In contrast, if the relevant expense caption comprises two or more of the expense items discussed in paragraph 17 of these materials, an entity would be required to separately disclose those expenses. With the exception of inventory disclosed under the cost-incurred basis, an entity is not required to further disaggregate costs capitalized as an asset even if the costs capitalized include required expense categories, such as employee compensation. For example, if an entity capitalizes employee costs to software (an asset) and in a subsequent reporting period that it recognizes an amortization expense, the entity is required to disaggregate the relevant expense caption that contains the amount amortized during the period but does not need to further disaggregate the resulting amortization.

21. Additionally, earnings or losses from equity method investments, in accordance with Topic 323, Investments—Equity Method and Joint Ventures, are not considered a relevant expense caption for purposes of applying the disaggregation requirements. An entity is not required to further disaggregate its disclosure of summarized information of operating results of equity-method investments.

22. Furthermore, in developing the disaggregation requirements, the Board considered several other disaggregation approaches (such as disaggregation of functional expense captions or a management internal view) but decided not to pursue them because stakeholder feedback on the 2023 proposed Update indicated that disaggregation of relevant expense captions into required categories provides investors with the most decision-useful information at a reasonable cost.

Required Expense Categories

Purchases of Inventory

23. The amendments in Update 2024-03 require the disaggregation of purchases of inventory in accordance with Topic 330. To distinguish the most common distinct nonrecurring transactions from purchases of inventory in the ordinary course of business, purchases of inventory should exclude amounts recognized in (a) a business combination, (b) a joint venture formation, and (c) an initial consolidation of a variable interest entity that is not a business. The Board concluded that inventory amounts recognized from those transactions should be disclosed in the “other” category of an entity’s disaggregation table, unless separately disclosed voluntarily.

24. The amendments in the 2023 proposed Update included inventory and manufacturing expense as a required expense category instead of the purchases of inventory category. However, when a relevant expense caption included amounts for inventory and manufacturing expense, the proposed amendments would have required that an entity further disaggregate inventory and manufacturing expense into certain categories, including the purchases of inventory category. After considering the feedback received on the 2023 proposed Update, the Board decided to remove inventory and manufacturing expense as a required expense category and, instead, require disclosure of the purchases of inventory as a required expense category. The Board determined that this change responds to stakeholder feedback because it creates a more intuitive single-level disaggregation.

25. A practical expedient for purchases of inventory is allowed when substantially all of an entity’s income statement expense caption comprises purchases of inventory in accordance with Topic 330 (for example, *purchases*, *purchases of materials*, or another similarly named caption). If this practical expedient is elected, the entity is not required to disaggregate that expense caption into required expense categories. Instead, the entity is required to disclose a qualitative description of the composition of the expense caption. The Board decided to provide the purchases of inventory practical expedient because it determined that the expected cost of disaggregating the purchases of inventory in accordance with Topic 330 from other purchases within the caption would outweigh the expected benefit.

26. The amendments in Update 2024-03 allow two different bases—cost-incurred basis and expense-incurred basis—for disclosing the disaggregation of a relevant expense caption that contains expense amounts related to inventory within Topic 330. Accordingly, under the following bases:

    a. For a cost-incurred basis, the required expense categories include amounts capitalized to inventory in accordance with Topic 330 and amounts that were directly expensed in the current reporting period (including amounts that were capitalizable to inventory but were directly expensed in the income statement).

b. For an expense-incurred basis, the required expense categories include period expenses that were directly expensed to the income statement and expenses incurred on the derecognition of inventory, which may relate to costs capitalized in prior periods. Under an expense incurred basis, an entity is required to include the expense amounts related to the derecognition of inventory based on the natural expense category of the costs when they were initially incurred (for example, a portion of the amount derecognized from inventory may relate to employee compensation and depreciation that was previously capitalized in a prior period).

27. Regardless of the basis selected by an entity, that basis should be applied consistently to all required expense categories that contain amounts within the scope of Topic 330 and disclosed in the entity's disaggregation disclosure. An entity would apply its selected basis to all of the required expense categories that have amounts within the scope of Topic 330. For example, if an entity selects the cost-incurred basis, it would apply that basis to purchases of inventory, employee compensation, intangible asset amortization, and depreciation within the relevant expense caption. Conversely, when a relevant expense caption does not include amounts within the scope of Topic 330, the disaggregation disclosure would not be subject to this alternative.

28. The Board decided to allow entities to disclose the required expense categories using either a cost-incurred basis or an expense-incurred basis in response to feedback on the 2023 proposed Update from preparers, investors, and other stakeholders. The Board concluded that allowing the cost-incurred basis responds to preparer feedback that indicated that it may be costly and difficult, or potentially impracticable, for many entities to retrospectively identify by required expense category costs capitalized as part of inventory that is sold in the current reporting period. However, the Board also heard feedback on the 2023 proposed Update that it should not limit the use of an expense-incurred basis because in some instances it may reduce implementation costs for entities that have current system capabilities to disclose the required information under that basis. In addition, in response to the 2023 proposed Update, investors indicated that obtaining the disaggregated expense information under either a cost-incurred basis or an expense-incurred basis would improve the decision usefulness of expense information included in an entity's financial statements.

Employee Compensation

29. The amendments in Update 2024-03 define the term *employee compensation* based on the current Master Glossary definition of the term *employee* as used in Topic 718, Compensation—Stock Compensation, and added the Master Glossary definition of *compensation* that is intended to broadly capture the major types of consideration granted or issued to employees in exchange for services. The Board amended the Master Glossary definition of *employee* to incorporate minor conforming changes that consider forms of compensation other than stock compensation. The Board also clarified

that the term *employee* includes, but is not limited to, a full-time, part-time, temporary, or seasonal employee.

30. As a practical expedient for determining what amounts are classified as employee compensation, an entity that presents an expense caption for salaries and employee benefits (or a similarly named caption) on the face of its income statement to comply with the requirements in SEC Regulation S-X Rule 210.9-04, statements of comprehensive income (see paragraph 942-220-S99-1), may use the amounts classified as salaries and employee benefits in accordance with SEC Regulation S-X Rule 210.9-04 rather than in accordance with the definition of employee compensation included in this Subtopic.

Depreciation and Intangible Asset Amortization

31. The amounts provided for depreciation and intangible asset amortization should be consistent with the classification of amounts used to satisfy the disclosure requirements for the total depreciation expense in Subtopic 360-10, Property, Plant, and Equipment—Overall, and total intangible asset amortization expense disclosures in Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill. The Board acknowledges that diversity in practice may exist about whether certain items are determined to be depreciation or intangible asset amortization. However, the Board concluded that revising long-standing disclosure requirements for those amounts would have added significantly to the time required to develop guidance in this project, could have disrupted current practice, and would not necessarily have benefited investors. While these two expenses are listed jointly in this paragraph, they are required to be presented separately.

Depreciation, Depletion, and Amortization

32. While the Board acknowledges that DD&A (or other amounts of depletion expense) is an industry-specific expense, DD&A was included as a separate required category because it represents a potentially significant noncash expense that is recognized systematically, like depreciation and intangible asset amortization. The Board also reasoned that establishing DD&A as a required category separate from depreciation and intangible asset amortization clarifies the requirements for entities with extractive or oil- and gas-producing activities, including those for which the amount of DD&A recognized becomes part of the cost of oil and gas produced.

33. Stakeholders broadly supported linking depreciation, intangible asset amortization, and DD&A to current guidance to enhance the operability of the amendments in Update 2024-03 and the comparability of disclosures across different entities.

Questions for Participants

6. The amendments in the Update require that an entity identify relevant expense captions on the income statement that would be subject to disaggregation in the notes to financial statements. In your experience thus far, is the identification of relevant expense captions operable? Do you expect that approach to present any challenges?
7. The amendments in the Update require that an entity disclose the amounts of the required expense categories (purchases of inventory; employee compensation; depreciation; intangible asset amortization; and depreciation, depletion, and amortization recognized as part of oil-and gas-producing activities (DD&A)) included in each relevant expense caption. In your experience thus far, are the required expense categories clearly defined and operable to apply?
8. If your entity has inventory within the scope of Topic 330, Inventory, do you intend to use the cost-incurred or expense-incurred approach? Are there any specific system or process constraints that factored into that decision?

Topic 3: Integration of Existing Disclosures and Qualitative Description of Other Items, Other Enhancements to the Disaggregation Requirements, and Selling Expenses

34. The purpose of Topic 3 is to summarize the guidance related to (a) the qualitative description of other items and the integration of certain existing disclosure requirements into the tabular expense disaggregation disclosure, (b) other enhancements to the disaggregation requirements, including the treatment of certain asset- and liability-related expenses, and the effects of cost-sharing and cost-reimbursement arrangements, and (c) the disclosure of selling expenses, including the requirement to disclose total selling expenses and an entity's definition of selling expenses.

Integration of Existing Disclosures

35. The Board considered a disaggregation approach that would have utilized a quantitative threshold to require further disaggregation of other expenses and costs remaining in relevant expense captions after the disaggregation of the required expense categories. Comment letter feedback on the 2023 proposed Update from preparers explained that additional quantitative disaggregation of other items would require that entities effectively perform a full disaggregation of relevant expense captions and would be costly. The Board concluded that a qualitative description of the amount remaining in each relevant expense caption in conjunction with the integration of current disclosure requirements into the tabular format disclosure more effectively balanced the expected benefits and expected costs.

36. The amendments in Update 2024-03 require that an entity include in the same tabular disclosure certain expenses, gains, and losses that are subject to existing disclosure requirements. All applicable items in paragraph 220-40-50-21 (see Appendix B) are required to be included in the same tabular disclosure. Applicable items in paragraph 220-40-50-22 (see Appendix B) are required to be included in the tabular disclosure *only* if the amount is presented entirely in one relevant expense caption in the income statement.

37. The amendments on the disaggregation of relevant expense captions into required expense categories and other disclosures do not apply to immaterial items. For example, if an entity has previously concluded that a disclosure in the lists in paragraph 220-40-50-21 or 220-40-50-22 is not required because of the application of the guidance in paragraph 105-10-05-6, the Board does not expect that the amendments in Update 2024-03 will affect that conclusion.

Qualitative Description of Other Items

38. An entity should disclose in the same tabular format used for required disaggregated expense information an "other items" amount for each relevant expense caption. This amount represents the difference between the total expense shown on the face of the income statement and the aggregate of the separately disclosed expense categories required under the referenced paragraphs. Entities must also provide qualitative descriptions explaining the natural expense components included in "other items," with the level of detail reflecting the significance of those amounts. Entities may further disaggregate relevant expense captions before applying this guidance to the remaining "other items".

Other Enhancements to the Disaggregation Requirements

39. In finalizing the amendments in Update 2024-03, the Board made several decisions to mitigate implementation costs and improve operability, as follows:

    a. *Guidance on the effects of cost-sharing and cost-reimbursement arrangements.* The amendments state that an entity that includes amounts that are recorded net of an expense reimbursement to another entity may either (i) disclose the required expense categories net of reimbursement amounts or (ii) disclose the aggregate reimbursement amount as a separate line item. Additionally, an entity that includes an expense reimbursement to another entity should separately include the amount of that reimbursement in the disclosure. Some stakeholders stated that, in practice, entities that receive reimbursements do not maintain reimbursement information at a sufficiently granular level to disclose the required expense categories net of reimbursement amounts and that entities that pay reimbursements do not receive sufficiently granular reimbursement information to determine the nature of the expenses to which those reimbursements relate.

    b. *Cost capitalized as an asset.* An entity is not required to further disaggregate costs capitalized as an asset, with the exception of inventory disclosed under the cost-incurred basis described in paragraph 26 of these materials, even if the costs capitalized include the categories described in paragraph 17 of these materials. For example, if an entity capitalizes employee costs to software (an asset) and in a subsequent reporting period it recognizes an amortization expense, the entity is required to disaggregate the relevant expense caption that contains the amount amortized during the period but does not need to further disaggregate the resulting amortization.

c. *Accrued expenses based on the obligation of an estimate of future expenditures to be incurred.* Some stakeholders expressed concern about the operability of disaggregating certain liability-related expenses (for example, insurance claims expense and asset retirement obligations) into required expense categories. An entity is not required to further disaggregate those liability-related expenses.

Selling Expenses

40. The amendments in Update 2024-03 require that an entity disclose selling expenses as well as how it defines selling expenses. Unless selling expenses is a relevant expense caption because an entity presents it as a separate caption on the face of the income statement, the entity is not required to further disaggregate the disclosed amount of selling expenses into the required expense categories. An entity's definition of selling expenses should include only items that are presented as expenses in the income statement. The disclosure of selling expenses is expected to enhance an investor's understanding of what management determines to be selling expenses as well as providing insights into costs that are more likely to vary based on changes in revenue.

41. Rather than providing prescriptive guidance, the Board decided to permit an entity to tailor the definition of selling expenses to its specific facts and circumstances. The Board determined that this will be less costly and more operable than if the Board had established a prescriptive definition to be applied by all entities; instead, entities are permitted to apply reasonable judgment when defining selling expenses. In addition, this approach of not defining selling expenses is consistent with the general lack of prescriptive definitions within GAAP for expense line items such as cost of goods sold or SG&A expenses.

Questions for Participants

9. For the integration of existing disclosure requirements (paragraph 220-40-50-21 or 220-40-50-22), do you expect those amounts to reduce "other items" in your tabular disclosures in a meaningful way?

10. Do you think complying with the requirement to qualitatively describe "other items" necessitates a detailed breakdown of all remaining expense amounts, or do you think entities can instead apply judgment to describe what remains?

Questions for Participants
11. Does any of the guidance outlined in paragraph 39 of these materials apply to your entity (or your clients)? Do you expect that those provisions will make implementation and application of the guidance more straightforward or are there additional questions?

Appendix A: Summarized History of the DISE Project

1. In 2004, the FASB and the IASB decided to work jointly on a project on financial statement presentation with the goal of establishing converged guidance.

2008 Discussion Paper

2. In 2008, the Boards issued a Discussion Paper, *Preliminary Views on Financial Statement Presentation*. That Discussion Paper explained that users of financial statements had told the Boards that although disaggregation into functions (such as cost of sales and general and administrative expenses) assists in the analysis of overall business trends (such as in gross margins and operating margins), it aggregates items with different economic drivers (for example, labor and raw materials) and, therefore, reduces the predictive value of the expense information. By contrast, disaggregating expenses by nature would separate expenses that have different economic characteristics. Therefore, the Boards proposed further disaggregating the functional captions by their nature. In comment letters and subsequent outreach, respondents noted that greater disaggregation of expense items would provide decision-useful information.

2010 Staff Draft

3. A draft for public comment, *Staff Draft of an Exposure Draft on Financial Statement Presentation*, was issued in 2010 jointly by the FASB staff and the IASB staff to serve as the basis for further outreach on the project. The Staff Draft had a broad scope and proposed changes to the requirements for presentation on the income statement, balance sheet, and statement of cash flows. Relevant to the amendments in Update 2024-03, the Staff Draft proposed a requirement that an entity disaggregate its expenses by function and then further disaggregate those functional amounts by nature to the extent that the information would be useful in assessing the amount, timing, and uncertainty of future cash flows. Users supported increased disaggregation, while preparers expressed several concerns about the proposal, including the costs associated with generating the information. Upon considering the feedback received, the Board removed the project on financial statement presentation from its technical agenda but continued researching related issues.

Subsequent Research and Invitation to Comment Feedback

4. In 2014, the Board added a research project focused on ways in which financial statement presentation could be improved by leveraging certain aspects of its previous project on financial statement presentation. That research project ultimately focused on financial performance reporting and considered potential improvements through disaggregation and changing the structure of the income statement.

5. In 2016, the Board requested feedback through the issuance of the Invitation to Comment, *Agenda Consultation* (2016 ITC). That document solicited feedback about the major areas of financial reporting that stakeholders noted should be improved. The 2016 ITC specifically highlighted four topical areas for stakeholders' consideration, the financial reporting issues related to each topical area, and some of the possible approaches that the Board could consider in addressing the identified issues. Those topics were identified based on the results of a 2015 Financial Accounting Standards Advisory Council survey that was conducted about the Board's agenda priorities, as well as feedback received from the Board's other advisory groups and other stakeholders. One of the topical areas focused on the reporting of an entity's performance, including the presentation and display of revenues, expenses, gains, and losses reported in the income statement, statement of other comprehensive income, segment disclosures required under Topic 280, Segment Reporting, or in other notes to financial statements.

6. Many respondents to the 2016 ITC stated that performance reporting was a priority area and supported efforts to provide greater granularity of performance information to show the different sources and characteristics of earnings through either presentation or disclosure in the notes to financial statements. Specifically, they stated that disaggregating performance information should be a priority for the Board's future agenda because it would increase the utility of the income statement in terms of predicting future earnings and cash flows.

7. In September 2017, the Board decided to add to its technical agenda a project on the disaggregation of performance information. The Board decided to focus the project on disaggregating certain expenses presented by function into natural components. In 2019, active research on the project was paused to monitor the progress of the Board's project on segment reporting and the IASB's project on primary financial statements.

8. In 2021, the Board issued an Invitation to Comment, *Agenda Consultation* (2021 ITC). In response, investors and other financial statement users stated that greater disaggregation of financial reporting information—in the income statement, in the statement of cash flows, or in the notes to financial statements—should be a top priority for the Board to help them better perform their analyses. Investors specifically requested more granular information about cost of sales and SG&A because greater granularity and detail of those expense captions would assist investors in understanding an entity's cost structure. Some investors also noted that employee compensation costs should be disclosed, ideally with details by line item.

9. In response to the 2021 ITC, some preparers indicated that they receive minimal questions on the disaggregation of financial reporting information and cash flows and, therefore, asserted that their investors already receive sufficient information.

10. In February 2022, the Board revised the scope and objective of the project in response to the feedback received on the 2021 ITC. At that time, the objective was revised to improve the decision usefulness of business entities' income statements through the disaggregation of certain expense captions.

2023 Proposed Update

11. On July 31, 2023, the Board issued the proposed Accounting Standards Update, *Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*, for public comment with the comment period ending on October 30, 2023. The Board received 80 comment letters in response to the 2023 proposed Update and conducted additional outreach with investors that use the financial statements and footnotes when making capital allocation decisions. Investors strongly supported the amendments in the 2023 proposed Update, noting that the additional expense information would allow them to better understand the factors driving expense trends, assess profitability and future cash flows, and improve their forecasting and trend analyses. Additionally, some investors commented that the proposed amendments would improve consistency and comparability across entities.

12. While many comment letter respondents and other stakeholders supported the Board's efforts to improve disclosures about a public business entity's expenses, preparers and other respondents generally expressed concerns about operability challenges and costs to implement the amendments, or certain aspects of the amendments, in the 2023 proposed Update. Some of those respondents questioned whether the expected benefits of the information resulting from the proposed amendments would justify the expected costs.

2023 Roundtable

13. On December 13, 2023, the Board hosted a public roundtable discussion with 25 external participants (including investors, preparers representing various industries, practitioners, and other stakeholders) to discuss the feedback received on the amendments in the 2023 proposed Update. The feedback at the roundtable discussion was generally consistent with the feedback received from comment letter respondents on the 2023 proposed Update and from additional outreach with investors.

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14. The overwhelming support from investors for the benefits articulated in the 2023 proposed Update led the Board to proceed with finalizing the amendments in Update 2024-03. The Board also considered other stakeholder feedback on how to improve the operability of the guidance.

15. In finalizing the amendments in Update 2024-03, as noted in paragraph BC28, the Board made several decisions to mitigate implementation costs, as follows:

a. *Specific expenses.* The Board decided to limit the disclosures to specific expenses and costs that will be most useful for investors. Feedback from preparers indicated that relative to an approach that would require the full disaggregation of functional expenses by nature, the approach pursued by the Board will be less costly because fewer types of natural expenses are required to be disclosed by function.

b. *Disclosure of amounts capitalized to inventory or expense amounts derecognized from inventory.* During the staff's initial outreach with stakeholders, many preparers indicated that a requirement to disaggregate inventory amounts into the required expense categories would be impracticable because entities would be unable to track the nature of costs capitalized to inventory through the production process. Therefore, the Board decided to allow the amounts disclosed for each expense category to include costs incurred that were capitalized to inventory during the period. The Board concluded that this cost-incurred approach would be less costly because an entity would not be required to determine the nature of costs capitalized in previous periods. However, some entities indicated that they have reporting systems in place that allow them to track natural expense information through the inventory production process; therefore, the Board decided that entities should be allowed to disaggregate the required categories on an expense-incurred basis.

c. *Disclosure and further disaggregation of inventory and manufacturing expense.* The amendments in the 2023 proposed Update would have required the disclosure and further disaggregation of *inventory and manufacturing expense*, which was a defined term within the proposed amendments. During the comment letter process, many stakeholders, in particular preparers and preparer-focused trade groups, expressed concerns about the operability and costs of disclosing and further disaggregating inventory and manufacturing expense. Specifically, those stakeholders observed that the requirement to further disaggregate inventory and manufacturing expense into certain cost incurred categories would require that an entity separately identify, track, and disclose manufacturing expenses (including inventory costs) from nonmanufacturing expenses. As a result of that feedback, the Board decided to remove the requirement to disclose and further disaggregate inventory and manufacturing expense and, instead, added the purchases of inventory category as a required disclosure in the final Update. The Board observed that removing the requirement to disclose and further disaggregate inventory and manufacturing expense would reduce the complexity of the disclosures and thereby reduce the related costs of the requirements, by including manufacturing expenses (including inventory costs) and nonmanufacturing expenses in a single-level disaggregation.

d. *Clarifications on identifying relevant expense captions.* For purposes of identifying relevant expense captions, the Board decided to clarify that:

   1. An expense caption that consists entirely of one required expense category is not subject to the disaggregation requirements. However, if the relevant expense caption is presented as a

natural expense classification on the face of the income statement and includes more than one of the required expense categories, additional disaggregation would be required.

2. An entity's share of profit or loss in an equity method investee and the entity's disclosure of summarized information of results of operations of equity method investees are not subject to the disaggregation requirements.

These clarifications will eliminate diversity in practice and, therefore, simplify the reporting requirements and reduce costs.

e. *Other items remaining.* The Board decided to require qualitative disclosure about the nature of expenses remaining in relevant expense captions rather than requiring additional quantitative disaggregation based on a quantitative threshold or principle.

f. Practical expedients:

1. The Board decided to permit entities (banks and bank holding companies) applying SEC Regulation S-X Rule 210.9-04 that present salaries and employee benefits to continue using a classification that satisfies that requirement rather than requiring that those entities apply the employee compensation definition that is included in Subtopic 220-40.

2. When substantially all of an entity's income statement caption comprises purchases of inventory within the scope of Topic 330 (such as purchases, purchases of materials, or another similarly named caption), the Board decided that the entity is required to qualitatively describe the composition of that expense caption instead of disclosing disaggregated amounts for that expense caption.

g. *Guidance on the effects of cost-sharing and cost-reimbursement arrangements.* The Board decided to permit an entity that includes amounts that are recorded net of an expense reimbursement to either (i) disclose the required expense categories net of reimbursement amounts or (ii) disclose the aggregate reimbursement amount as a separate line item. The Board also decided to permit an entity that includes an expense reimbursement to another entity to separately include the amount of that reimbursement in the disclosure. Some stakeholders stated that, in practice, entities that receive reimbursements do not maintain reimbursement information at a sufficiently granular level to disclose the required expense categories net of reimbursement amounts and that entities that pay reimbursements do not receive sufficiently granular reimbursement information to determine the nature of the expenses to which those reimbursements relate. Therefore, this guidance will reduce costs.

h. *Accrued expenses based on the obligation of an estimate of future expenditures to be incurred.* Some stakeholders expressed concern about the operability of disaggregating certain liability-related expenses (for example, insurance claims expense and asset retirement obligations) into required expense categories. The Board decided that not requiring an entity to further disaggregate those liability-related expenses will reduce costs and be more operable.

i. *Discretion for defining the term selling expenses.* Rather than providing prescriptive guidance, the Board decided to permit an entity to tailor the definition of the term *selling expenses* to its specific facts and circumstances. The Board determined that this will be less costly and more operable than if the Board had established a prescriptive definition to be applied by all entities; instead, entities are permitted to apply reasonable judgment when defining selling expenses. In addition, this approach of not defining selling expenses is consistent with the general lack of prescriptive definitions within GAAP for expense line items such as cost of goods sold or SG&A expenses.

j. *Use of estimates or other methods of approximation.* The Board decided to clarify that an entity may use estimates or other methods that produce a reasonable approximation of the amounts required to be disclosed, which will alleviate broad concerns about potential reporting system and process limitations in preparing the disclosures and ultimately will reduce costs.

k. *Private companies.* The Board decided to exclude private companies from the scope of the amendments.

l. *Transition.* The Board understands that much of the information required to prepare the disclosures is not readily available today. Accordingly, the Board determined that it will be less costly to require that the disclosures be applied prospectively rather than retrospectively.

Appendix B: Tabular Integration of Other Disclosure Requirements

1. Paragraph 220-40-50-21 includes a list of certain expenses, gains, and losses that should be disclosed in the same tabular format as required by paragraph 220-40-50-6:

> An entity shall disclose, in the same tabular format disclosure in which the disclosures required by paragraph 220-40-50-6 are provided, each of the following expenses, gains, and losses and the amount recognized in each relevant expense caption (see paragraphs 220-40-50-12 through 50-13 for guidance on identifying relevant expense captions):
>
> a. The amount of research and development assets acquired in a transaction other than a business combination and written off (see paragraph 350-30-50-1(c))
>
> b. Impairment loss recognized related to an intangible asset (see paragraph 350-30-50-3)
>
> c. Impairment loss of long-lived assets classified as held and used (see paragraph 360-10-50-2)
>
> d. Gain or loss recognized in accordance with paragraphs 360-10-35-37 through 35-45 and 360-10-40-5 for long-lived assets classified as held for sale or disposed of (see paragraph 360-10-50-3)
>
> e. Each major type of cost associated with an exit or disposal activity (for example, one-time employee termination benefits, contract termination costs, and other associated costs) (see paragraph 420-10-50-1)
>
> f. Components of net benefit cost recognized (other than service cost amounts included within employee compensation) (see paragraph 715- 20-50-1(h))
>
> g. Bargain purchase gain recognized in a business combination (see paragraph 805-30-50-1(f))
>
> h. Any gain or loss recognized upon the deconsolidation of a subsidiary or the derecognition of a group of assets in accordance with paragraph 810-10-40-3A (see paragraph 810-10-50-1B)
>
> i. Gains and losses on derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments in accordance with paragraphs 815-20-25-58 and 815-20-25-66) and related hedged items (see paragraph 815-10-50-4A)
>
> j. Amortization of license agreements for program material (see paragraph 920-350-50-2)
>
> k. Impairment of license agreements for program material (see paragraph 920-350-50-4)
>
> l. Amortization of film costs (see paragraph 926-20-50-4A)
>
> m. Impairment of film costs (see paragraph 926-20-50-4C)
>
> n. The total amount of a government grant recognized during the reporting period and presented as a deduction from the related

expense (see paragraphs 832-10-45-1(b), 832-10-45-3(b), and 832-1-50-3A)

o. Total expense recognized for environmental credits not initially recognized as an asset in accordance with paragraph 818-20-25-1 or subsequently derecognized in accordance with paragraph 818-20-40-2 (see paragraph 818-20-50-3(a))

p. Total impairment expense recognized during the reporting period relating to environmental credits (see paragraph 818-20-50-3(b))

q. Total expense recognized for environmental credit obligation liabilities (see paragraph 818-30-50-3).

These disclosures shall be included in the tabular format disclosure required by paragraph 220-40-50-6 using the same frequency (that is, whether the disclosure is required at interim and annual reporting periods or only annual reporting periods) as required by the corresponding Topic.

2. Paragraph 220-40-50-22 includes a list of certain items that when they are included entirely in one expense caption that also is a relevant expense caption, should be disclosed in the same tabular format as required by paragraph 220-40-50-6:

> An entity shall disclose, in the same tabular format disclosure in which the disclosures required by paragraph 220-40-50-6 are provided, each of the following amounts if those amounts are included entirely in one expense caption that also is a relevant expense caption (see paragraphs 220-40-50-12 through 50-13 for guidance on identifying relevant expense captions):
>
> a. Provision for expected credit losses (see paragraphs 326-20-50-13 and 326-30-50-9)
>
> b. Losses on firm purchase commitments (see paragraph 330-10-50-5)
>
> c. Amortization expense attributable to the expiration of an insurance or reinsurance coverage provided under a contract that transfers only significant underwriting risk (see paragraph 340-30-50-2)
>
> d. Amortization of costs to fulfill a contract with a customer (see paragraph 340-40-50-3)
>
> e. Impairment of costs to fulfill a contract with a customer (see paragraph 340-40-50-3)
>
> f. Amortization of costs to obtain a contract with a customer (see paragraph 340-40-50-3)
>
> g. Impairment of costs to obtain a contract with a customer (see paragraph 340-40-50-3)
>
> h. Amortization of capitalized implementation costs of hosting arrangements that are service contracts (see paragraph 350-40-50-3)
>
> i. Asset retirement obligation accretion expense (see paragraph 410- 20-50-1)
>
> j. Loss contingencies recognized (see paragraph 450-20-50-1)

k. Warranty expense (the total of expenses recognized related to aggregate changes in the liability for accruals related to product warranties issued during the reporting period and the aggregate changes in the liability for accruals related to preexisting warranties, including adjustments related to changes in estimates) (see paragraph 460-10-50-8)

l. Expense related to counterparty default in own-share lending arrangements issued in contemplation of convertible debt issuance (see paragraph 470-20-50-2C)

m. Aggregate gain on restructuring of payables by a debtor with a troubled debt restructuring (see paragraph 470-60-50-1)

n. Gains and losses upon consolidation of a variable interest entity that is not a business (see paragraph 810-10-50-3)

o. Foreign currency transaction gains or losses (see paragraph 830-20- 50-1)

p. Operating lease cost (see paragraph 842-20-50-4)

q. Short-term lease cost (see paragraph 842-20-50-4)

r. Variable lease cost (see paragraph 842-20-50-4)

s. Net gain or loss recognized from sale and leaseback transactions (see paragraph 842-20-50-4)

t. Gains and losses from nonmonetary transactions (see paragraph 845- 10-50-1)

u. Amortization of capitalized acquisition costs (see paragraph 944-30- 50-1(c)).

These disclosures shall be included in the tabular format disclosure required by paragraph 220-40-50-6 using the same frequency (that is, whether the disclosure is required at interim and annual reporting periods or only annual reporting periods) as required by the corresponding Topic.

Appendix C: Illustrative Examples

Overview

The amendments in Accounting Standards Update No. 2024-03, *Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses,* require that a public business entity disclose specific information about certain costs and expenses in the notes to its financial statements for interim and annual reporting periods.

In developing Update 2024-03, stakeholders expressed concerns that an entity would be required to use transaction-level detail to determine the amounts of each required expense category. A requirement to use transaction-level detail could be costly and burdensome due to intra-entity departmental allocations, costing and absorption approaches, and other bookkeeping practices applied in the preparation of consolidated financial statements.

The Board considered that feedback and clarified in paragraph BC53 of Update 2024-03 that "it did not intend for an entity to prepare the disclosure requirements using transaction-level details; instead, an entity may take a reasonable approach to prepare the disclosure information in a systematic and rational way." Paragraph 220-40-50-1 in part states:

> An entity shall consider the level of detail necessary to satisfy the disclosure objective and specific requirements of this Subtopic. An entity may use estimates or other methods that produce a reasonable approximation of the amounts required to be disclosed by this Subtopic.

Question

How should an entity use estimates to produce a reasonable approximation of the amounts for disclosures required by Subtopic 220-40, Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures?

Interpretive Response

An entity may satisfy the disclosure requirements by applying a reasonable, systematic, and rational approach. In doing so, an entity may use estimates or other methods that result in a reasonable approximation of the amounts required to be disclosed by Subtopic 220-40. The approach will depend on the entity's facts and circumstances, including the design of its systems, processes, and controls and whether transaction-level information is readily available. Management should exercise judgment in determining when estimates or alternative methods are appropriate. Furthermore, the disaggregation of relevant expense captions and related disclosure requirements do not apply to immaterial amounts.[1]

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[1] Paragraph 105-10-05-6 states "the provisions of the Codification need not to be applied to immaterial items."

The following examples are intended to illustrate potential approaches that entities may consider; they are not intended to be the only acceptable approaches. The examples use slightly different fact patterns and terminology to reflect different facts and circumstances that may exist in practice.

Example One Facts

Entity A is a service company that does not have manufacturing operations. Entity A identified the following relevant expense captions: cost of sales and selling, general, and administrative expenses (SG&A). Those expense captions were identified as relevant expense captions because they contain one or more of the expense categories listed in paragraph 220-40-50-6.

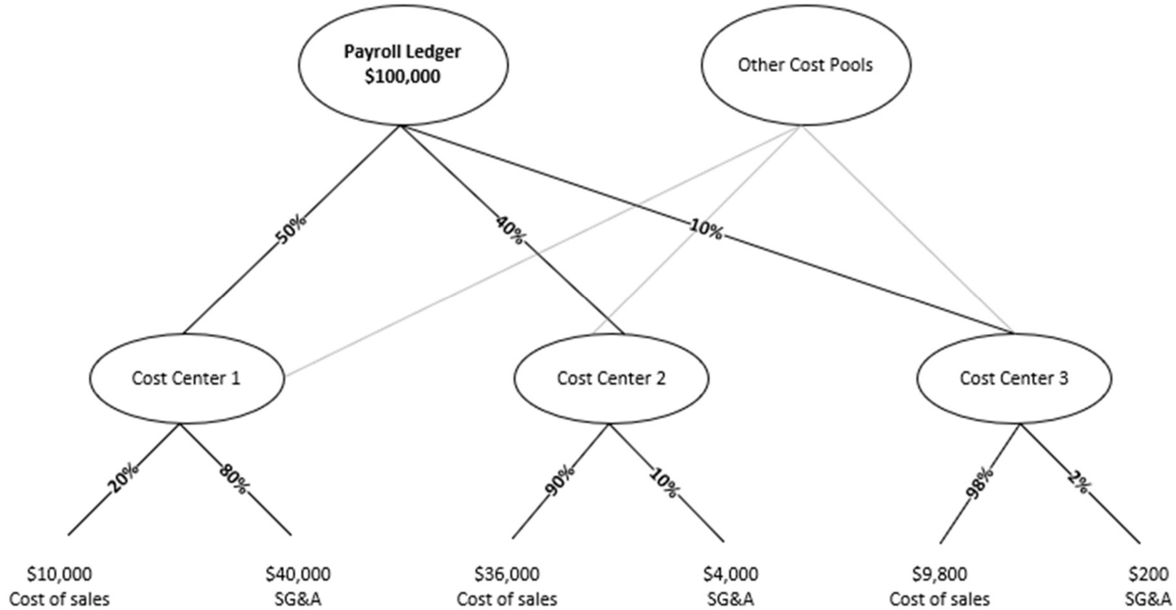
Entity A determined that it will use estimates to produce a reasonable approximation to disaggregate employee compensation from the relevant expense captions.

The payroll ledger has **$100,000** in total employee costs incurred during the period, which is allocated to three cost centers. The amounts in the payroll ledger meet the Master Glossary definition of the term *employee compensation.* Entity A maintains reliable historical information about how payroll is typically allocated across operational cost centers as well as current period allocation information. Entity A does not capitalize any of its employee compensation. On the basis of the current allocation approach used in the general ledger, employee compensation is allocated as follows:

- **50%** to Cost Center 1
- **40%** to Cost Center 2
- **10%** to Cost Center 3.

Each cost center receives allocated costs from multiple shared services across the organization, such as payroll, IT, facilities, and accounting. For purposes of disaggregating employee compensation, Entity A applies known allocation patterns to estimate how employee compensation flows to income statement expense captions. Those patterns reflect how employee compensation costs incurred by each cost center are typically capitalized or expensed in the normal course of business and are consistently applied for internal reporting and financial statement preparation purposes.

- Cost Center 1 expenses **20%** to cost of sales and **80%** to SG&A
- Cost Center 2 expenses **90%** to cost of sales and **10%** to SG&A
- Cost Center 3 expenses **98%** to cost of sales and **2%** to SG&A.



Example One Estimation Process

The entity begins by identifying the employee compensation cost pool using the payroll ledger, which has total payroll costs of **$100,000** for the period. Applying those percentages (listed in the facts) to total payroll results in estimated employee compensation of:

- **$50,000** (50% x $100,000) for Cost Center 1
- **$40,000** (40% x $100,000) for Cost Center 2
- **$10,000** (10% x $100,000) for Cost Center 3.

For Cost Center 1, **20%** of employee compensation is expensed to cost of sales and **80%** is expensed to SG&A. Applying those percentages to the estimated **$50,000** of employee compensation for Cost Center 1 results in **$10,000** (20% x $50,000) of employee compensation estimated to be expensed to cost of sales during the period and **$40,000** (80% x $50,000) estimated to be expensed to SG&A.

For Cost Center 2, **90%** of employee compensation is expensed to cost of sales and **10%** is expensed to SG&A. Applying those percentages to the estimated **$40,000** of employee compensation allocated to Cost Center 2 results in **$36,000** (90% x $40,000) of employee compensation estimated to be expensed to cost of sales and **$4,000** (10% x $40,000) estimated to be expensed to SG&A.

For Cost Center 3, management concludes that **98%** of employee compensation is expensed to cost of sales, and the remaining **2%** is immaterial. The entity is aware that the **2%** is allocated elsewhere, but due to materiality considerations, the entity decided to allocate **100%** to cost of sales. Accordingly, the entity estimates that the full **$10,000** of employee compensation allocated to Cost Center 3 is expensed to cost of sales.

After applying these estimates, the entity aggregates employee compensation across cost centers by income statement expense caption. As a result, estimated employee compensation totals by relevant expense captions are as follows:

- Cost of sales = **$56,000** ($10,000 Cost Center 1 + $36,000 Cost Center 2 + $10,000 Cost Center 3)
- SG&A = **$44,000** ($40,000 Cost Center 1 + $4,000 Cost Center 2).

This approach produces a reasonable approximation of how employee compensation is allocated to relevant expense captions based on observable historical allocation data and known cost center allocations. The resulting amounts represent the underlying employee compensation costs based on a reasonable, systematic, and rational estimation approach. Entity A does not need to compare these amounts back to actual employee compensation expenses in order to assess the reasonableness of its approach.

Example Two Facts

Entity B is a service company with minimal manufacturing operations. Entity B identified the following relevant expense captions: cost of sales, SG&A, and manufacturing expense. Those expense captions were identified as relevant expense captions because they contain one or more of the expense categories listed in paragraph 220-40-50-6.

Entity B determined that it will use estimates to produce a reasonable approximation to disaggregate employee compensation from the relevant expense captions.

Entity B is a corporation with multiple business segments, business units, and divisions. Shared service costs, including employee costs, are generally allocated to the business unit level.

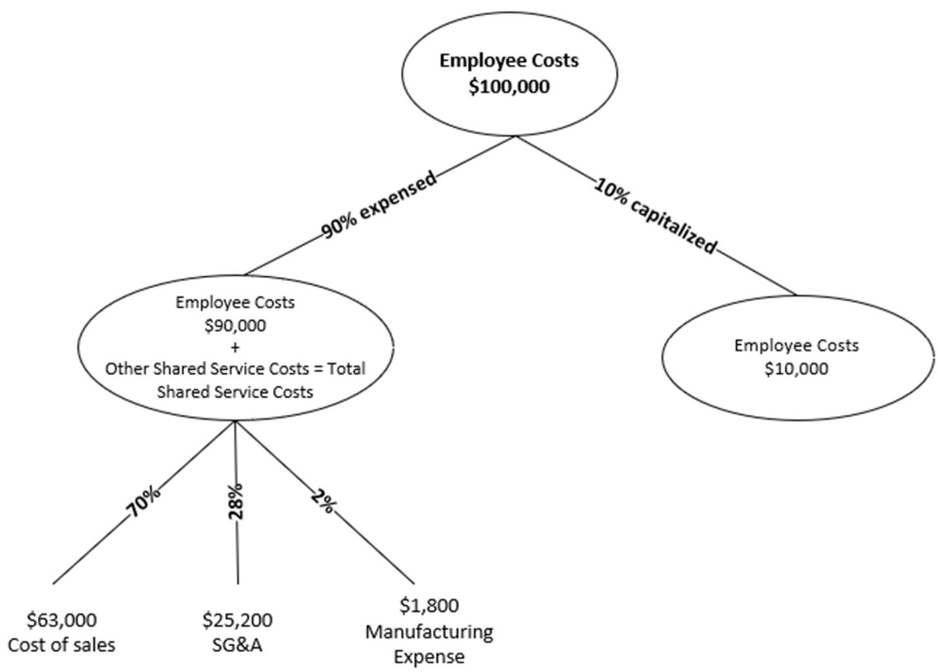
Employee costs are commingled with other shared service related costs before allocation to business units. Expense caption reporting on the income statement is based on individual business unit configurations (mapping). Therefore, the reporting of total shared service costs on the income statement is used as a proxy for allocating employee compensation expense to expense captions.

Employee costs include both capitalized and expensed costs and are derived from multiple underlying payroll ledgers. The capitalized cost assumption was derived from the business unit's current capital project portfolio that is maintained outside the general ledger. Capitalized labor was estimated by applying the capital projects' hourly rates to labor associated with these projects, resulting in a capitalized component representing approximately **10%** of total employee costs.

Entity B incurred **$100,000** of total employee costs incurred during the period, which meet the Master Glossary definition of the term employee compensation. Employee compensation costs are combined with other shared service related costs (for example, IT applications and facilities) and allocated to business units. Entity B maintains reliable historical information about how total shared service costs are typically allocated to expense captions as well as current-period allocation information. Entity B capitalizes **10%** of its employee compensation costs.

Each business unit receives allocated costs from multiple shared service cost functions across the organization, such as payroll, IT, facilities, and accounting. For purposes of disaggregating employee compensation, Entity B applies known allocation patterns to estimate how employee compensation flows to income statement expense captions. These patterns reflect how total shared service costs incurred by each business unit are typically expensed in the normal course of business and are consistently applied for internal reporting and financial statement preparation purposes. On the basis of the historical and current allocation approach used in the general ledger, total shared service costs on the income statement is used as a proxy for allocating employee compensation expense to expense captions as follows:

- **70%** to cost of sales
- **28%** to SG&A
- **2%** to manufacturing expense.



Example Two Estimation Process

The entity begins by identifying the employee cost pool, which has total payroll costs of $100,000 for the period. Applying the capitalization rate (listed in the facts) to total employee costs results in estimated employee compensation of:

- **$90,000** (90% x $100,000) expensed (income statement)
- **$10,000** (10% x $100,000) capitalized (balance sheet).

On the income statement, **70%** of total shared service costs of the business unit are expensed to cost of sales. Applying that percentage to the estimated **$90,000** of employee costs results in $63,000 (70% x $90,000) of employee compensation estimated to be expensed to cost of sales during the period.

In addition, **28%** of total shared service costs of the business unit are expensed to SG&A. Applying that percentage to the estimated **$90,000** of employee costs results in **$25,200** (28% x $90,000) of employee compensation estimated to be expensed to SG&A.

Management concludes that the remaining **2%** of employee costs that are allocated to manufacturing expense is immaterial. Due to materiality considerations, the entity decided not to disaggregate the employee compensation component of manufacturing expense.

As a result, estimated employee compensation by relevant expense captions are as follows:

- Cost of sales = **$63,000**
- SG&A = **$25,200.**

This approach produces a reasonable approximation of how employee compensation is allocated to relevant expense captions based on observable historical and current allocation data. The resulting amounts represent the underlying employee compensation costs based on a reasonable, systematic, and rational estimation approach. Entity B does not need to compare these amounts back to actual employee compensation expenses in order to assess the reasonableness of its approach.