

Disaggregation—Income Statement Expenses

January 31, 2024

Meeting Purpose

1. The purpose of the January 31, 2024 Board meeting is to (a) discuss feedback received on proposed Accounting Standards Update, [*Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures \(Subtopic 220-40\): Disaggregation of Income Statement Expenses*](#), through investor outreach, comment letters, and the public roundtable and (b) begin redeliberations. Detailed feedback is included in the [investor feedback summary](#), [comment letter summary](#), and [public roundtable meeting minutes](#).

Questions for the Board

Issue A: Expense Captions Subject to Disaggregation Requirements

1. Does the Board want to affirm its decision on the approach for identifying expense captions for disaggregation?
2. Does the Board want the staff to perform further work on the following alternatives or suggestions provided by stakeholders?
 - (a) Clarify the effects of proportionate consolidation, joint ventures, and other cost-sharing arrangements.
 - (b) Provide additional guidance for certain industries.
 - (c) Provide additional clarification for identifying relevant expense captions when income statements are presented using only natural expense categories or a mix of both functional and natural expense categories.
 - (d) Develop practical expedients, for example, when substantially all of a relevant expense caption consists of one required expense category.
 - (e) Explore potential scope exceptions or relief on items that may be quantitatively material but may not provide investors with decision-useful information.
 - (f) Provide additional clarification on the application of materiality guidance to the proposed amendments.
 - (g) Disclose total amounts for each required expense category in addition to the proposed disclosures for each relevant expense caption.
 - (h) Explore whether and how an entity may determine the amounts disclosed for each required expense category using accounting estimates or other methods.

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

- (i) Other application guidance or clarifications.

Issue B: Required Expense Categories, excluding Inventory and Manufacturing Expense

- 3. Does the Board want to affirm its decision on requiring disclosure of the following natural expense categories for each relevant expense caption?
 - (a) Employee compensation
 - (b) Depreciation
 - (c) Intangible asset amortization.
- 4. Does the Board want the staff to perform further work on the following alternatives or suggestions provided by stakeholders?
 - (a) Explore targeted improvements to the definitions and linkages to other Subtopics that were included in the proposed Update.
 - (b) Explore whether to expand employee compensation to include other workforce costs or require disclosure about other workforce costs.
 - (c) Replace depreciation, depletion, and amortization recognized as part of oil- and gas-producing activities (DD&A) with depletion and expand the scope of that expense category beyond oil and gas entities.
 - (d) Provide guidance about how an entity should present additional expense information that it voluntarily discloses beyond the required expense categories and corresponding definitions.
 - (e) Further disaggregate employee compensation into types of cash and noncash components.
 - (f) Further disaggregate intangible asset amortization into amortization of acquired intangible assets and amortization of internally developed intangible assets.
 - (g) Other alternatives or suggestions.

Issue C: Integration of Existing Disclosures with Mapping Requirements

- 5. Does the Board want to affirm its decision on integrating existing disclosures with income statement mapping requirements?
- 6. Does the Board want to provide guidance on whether entities should be permitted to remove amounts, or rather be required to duplicate amounts, that are disclosed in accordance with paragraph 220-40-50-12 from other disclosures in the notes to financial statements?

Issue D: Qualitative Description of Other Items

- 7. Does the Board want to affirm its decision on requiring the disclosure of a qualitative description of other items?

Issue E: Selling Expenses

- 8. Does the Board want to affirm its decision on requiring entities to disclose total selling expenses (as defined by the entity)?

9. Does the Board want the staff to perform further work on the following examples of potential implementation guidance that may assist entities with defining selling expenses?
- (a) Clarify how the existing advertising expense disclosure requirement interacts with the proposed selling expense disclosure (for example, clarify whether advertising expense is a component of selling expense).
 - (b) Provide examples of the other types of expenses that an entity may consider including in its definition of selling expenses (for example, the types of expenses described in the illustrative examples of selling expense disclosures in the proposed Update).
 - (c) Clarify the nature of the amounts to include in the proposed selling expense disclosure (that is, clarify that selling expenses should include only amounts that are presented as expenses on the income statement within continuing operations).
 - (d) Identify the disclosures that an entity may need to provide when it elects to change its definition of selling expenses in a subsequent reporting period.

Other Issues and Next Steps

10. Does the Board want to affirm its decision that the proposed amendments only apply to public business entities (PBE)?
11. Does the Board want the staff to perform further work on the following proposed requirements?
- (a) Scope, such as:
 - (i) Explore additional scope exceptions for certain entities (for example, smaller reporting companies, entities that are PBEs but are nonissuers), and/or entities in certain industries.
 - (ii) Other alternatives or suggestions.
 - (b) Inventory and manufacturing expense, such as:
 - (i) Revise the required expense category to inventory expense rather than inventory and manufacturing expense.
 - (ii) Explore an option to further disaggregate inventory and manufacturing expense based on the amounts expensed to the income statement.
 - (iii) Develop an inventory rollforward.
 - (iv) Consider a threshold under which an entity would not be required to further disaggregate inventory and manufacturing expense.
 - (v) Other alternatives or suggestions.
 - (c) Integration of existing disclosures without income statement mapping requirements, such as:
 - (i) Remove the condition for including existing disclosures listed in paragraph 220-40-50-13 if they are included entirely in one relevant expense caption.
 - (ii) Other alternatives or suggestions.

12. Does the Board have any other feedback on areas that it would like the staff to perform work on or questions on next steps?

Project Background

2. The objective of the amendments in the proposed Update is to improve the disclosures about a public business entity's expenses.
3. To achieve the project's objectives, the Board decided to require that entities would disclose additional information about specific expense categories (such as employee compensation) that are included in expense captions commonly presented on the income statement (such as cost of sales) on an annual and interim basis in the notes to financial statements. For inventory and manufacturing expense, the proposed amendments would require further disaggregation of those amounts into specific cost categories using a costs incurred approach. Additionally, the proposed amendments would require that an entity disclose information about selling expenses.

Summary of Issues for Redeliberation

Issue	Question for the Board	Additional Information
A	Question 1: Does the Board want to affirm its decision on the approach for identifying expense captions for disaggregation?	If the Board affirms its previous decisions on this issue, the final Update would require that an entity identify relevant expense captions for expense disaggregation. A relevant expense caption is any expense caption that: <ul style="list-style-type: none"> (a) Is presented on the face of the income statement within continuing operations (b) Contains at least one of the required expense categories.
	Question 2: Does the Board want the staff to perform further work on the alternatives or suggestions that are listed in Questions 2(a) through 2(i)?	The staff will perform further work on any alternatives or suggestions that are decided on by the Board. The output of that work will be discussed at a future Board meeting.
B	Question 3: Does the Board want to affirm its decision on requiring disclosure of the following natural expense categories for each relevant expense caption? <ul style="list-style-type: none"> a. Employee compensation b. Depreciation c. Intangible asset amortization. 	If the Board affirms its previous decisions on these proposed expense categories, the final Update would require that an entity disclose amounts for each of these expense categories in each relevant expense caption.

Issue	Question for the Board	Additional Information
	Question 4: Does the Board want the staff to perform further work on the alternatives or suggestions that are listed in Questions 4(a) through 4(g)?	The staff will perform further work on any alternatives or suggestions that are decided on by the Board. The output of that work will be discussed at a future Board meeting.
C	Question 5: Does the Board want to affirm its decision on integrating existing disclosures with income statement mapping requirements?	If the Board affirms its previous decisions on this proposed requirement, the final Update would require that an entity include certain existing disclosures in the same tabular format disclosure as the disaggregation of relevant expense captions. Specifically, an entity would include the disclosure of certain expenses, gains, and losses for which there is an existing requirement to disclose the amount and the income statement caption(s) to which the amount is recorded.
	Question 6: Does the Board want to provide guidance on whether entities should be permitted to remove amounts, or rather be required to duplicate amounts, that are disclosed in accordance with paragraph 220-40-50-12 from other disclosures in the notes to financial statements?	If the Board decides to provide guidance on this issue, the final Update would specify whether an entity would be required to duplicate amounts that are disclosed in accordance with both paragraph 220-40-50-12 and other corresponding disclosure requirements.
D	Question 7: Does the Board want to affirm its decision on requiring the disclosure of a qualitative description of other items?	If the Board affirms its previous decisions on this proposed requirement, the final Update would require that an entity qualitatively describe the nature of other expenses included in a relevant expense caption that are not required to be quantitatively disaggregated.
E	Question 8: Does the Board want to affirm its decision on requiring entities to disclose total selling expenses (as defined by the entity)?	If the Board affirms its previous decisions on this issue, the final Update would require that an entity disclose total selling expenses and how it defines selling expenses.
	Question 9: Does the Board want the staff to perform further work on the examples of potential implementation guidance that are listed in Questions 9(a) through 9(d)?	The staff will perform further work on any examples of potential implementation guidance that are decided on by the Board. The output of that work will be discussed at a future Board meeting.
Other Issues and Next Steps	Question 10: Does the Board want to affirm its decision that the proposed amendments only apply to public business entities (PBE)?	If the Board affirms its previous decisions on this issue, the final Update would not apply to private companies, not-for-profit entities, or employee benefit plans.
	Question 11: Does the Board want the staff to perform further work on the proposed amendments that are listed in Questions 11(a) through 11(c)?	The staff will perform further work on any of these proposed amendments that are decided on by the Board. Inventory and manufacturing expense alternatives may include: a. Inventory and manufacturing expense as a required expense category

Issue	Question for the Board	Additional Information
		<p>b. The further disaggregation of inventory and manufacturing expense.</p> <p>The output of that work will be discussed at a future Board meeting.</p>
	Question 12: Does the Board have any other feedback on areas that it would like the staff to perform work on or questions on next steps?	N/A

Investor Feedback Summary on the Proposed Accounting Standards Update on Disaggregation of Income Statement Expenses

4. In order to supplement feedback received through comment letters, the Board performed additional outreach with investors and certain academics during the comment period.
5. The purpose of this summary is to provide a summary of the feedback received on the proposed Update from the outreach interviews. Feedback from comment letters received on the proposed Update is summarized in the [comment letter summary](#).
6. This summary is structured as follows:
 - (a) Outreach Participants and Interviews
 - (b) Executive Summary
 - (c) Key Proposal 1: Disaggregating Relevant Expense Captions into Required Expense Categories
 - (d) Key Proposal 2: Further Disaggregation of Inventory and Manufacturing Expense
 - (e) Key Proposal 3: Disclosure of Selling Expense
 - (f) Key Proposal 4: Qualitative Disclosure of Other Items and Integration of Existing Disclosures
 - (g) Other Aspects of the Proposed Update:
 - (h) Disclosure Frequency
 - (i) Transition Method
 - (j) Other Feedback.

Outreach Participants and Interviews

7. The staff conducted interviews with 19 investors and 2 academics. The investor interviewees represent a variety of profiles, including but not limited to, portfolio managers,

- credit rating analysts, buy-side analysts, and sell-side analysts. More than half of the participants are generalists while the remaining participants cover a broad spectrum of industry groups, including media, technology, consumer products, industrial products, utilities, banking, and insurance.
8. As part of each interview, the staff summarized the key proposals and provided participants with an abridged sample disclosure.
 9. For each of the key proposals, participants were asked to answer the following questions:
 - (a) Would the proposal be useful in analyzing expense information?
 - (b) How would you use the information?
 - (c) What other observations do you have?
 10. Participants were asked to answer the following questions related to certain key proposals:
 - (a) Are there any other expense categories that are critical to break out from expense lines on the income statement?
 - (b) Should a definition of selling expenses be developed or should an entity be required to determine for itself (and disclose) what constitutes a selling expense?
 11. Additionally, participants were asked to answer questions on other proposed requirements, including those related to the integration of existing disclosures in the tabular format disclosure, the proposed reporting frequency, and the proposed transition guidance.

Executive Summary

12. While outreach participants offered nuanced commentary on each of the proposals included in the outreach materials, some common views were held by a majority of the participants. Those key takeaways are summarized below.

The Amendments in the Proposed Update Were Well Received by Investors

13. Investors strongly supported the amendments in the proposed Update, providing comments such as “transformational” and “huge win” when describing their sentiments that the proposed amendments would improve the quality of performance reporting. Specifically, investors indicated that the proposed disclosures would provide more relevant, reliable, and comparable expense information that would enhance their ability to forecast, compare, and assess profitability and potential future cash flows. Most outreach participants also supported requiring the proposed disclosures on an interim basis and applying the disclosures prospectively.

The Proposed Amendments Could Go Further

14. While outreach participants agreed that the required expense categories are the most common types of expenses across industries that would provide investors with decision-useful information, there were concerns that those expense categories may not result in sufficient disaggregation of income statement expense captions. Various suggestions were provided, such as adding more required expense categories and introducing a quantitative threshold to further disaggregate other expenses.
15. Outreach participants also provided other suggestions to improve the proposed amendments, including:
 - (a) Further disaggregating certain required expense categories (for example, separately disclosing the salary and bonus components of employee compensation)
 - (b) Further disaggregating selling expense into the required expense categories when selling expense is presented with other expenses (for example, general and administrative) on the face of the income statement
 - (c) Applying the costs incurred approach to assets other than inventory (for example, software)
 - (d) Disclosing the total cost incurred for a particular cost category (for example, total employee compensation cost) and bifurcating that amount between amounts capitalized and amounts expensed during the period
 - (e) Providing the proposed disclosures at the segment level.

Cost Concerns Were Acknowledged

16. Some investors acknowledged the costs that preparers would incur to provide disaggregated expense information, including the potential that those disclosures could share competitively sensitive information. Accordingly, a few of those investors indicated that a balance of benefits and costs needs to be considered for disaggregating expense information. For example, one investor commented that the Board's decision to reduce costs by describing other expenses (rather than requiring additional quantitative disaggregation) is a reasonable "middle ground" solution to balance benefits and costs. Another investor suggested disclosing only the total amounts of required expense categories without mapping those amounts to each relevant expense caption to further reduce complexity.

Key Proposal 1: Disaggregating Relevant Expense Captions into Required Expense Categories

Why the Information Would Be Useful

17. Investors broadly supported disclosing the required expense categories in each relevant expense caption. The following reasons were provided as to why the incremental disclosures would make performance reporting information more:
- (a) *Relevant.* All outreach participants said that the disaggregation of expense components with different economic characteristics would provide investors with better information for understanding an entity's operations and performance. Most of those investors highlighted that the breakout between cost of goods sold (COGS) and selling, general, and administrative (SG&A) expenses is critical to better understand gross margins versus operating margins. Investors also commented that the required expense categories are the "big ticket items" that would allow them to distinguish between fixed and variable expenses or between cash and noncash expenses. Some investors explained that information about fixed costs, such as depreciation and intangible asset amortization, and variable costs, such as inventory and manufacturing expense and certain components of employee compensation, would help them better understand an entity's incremental margins. Additionally, some investors stated that having visibility into variable expenses related to inventory and manufacturing activities would help them to more accurately assess the effects of changes in economic conditions (for example, changes in commodity prices) on an entity's operations and profitability, especially in an inflationary environment and for a cyclical business.
 - (b) *Reliable.* The details of expense components in COGS, SG&A, and similar income statement captions would provide transparency into the income statement classification decisions made by management and the effects of those decisions on important measures, such as gross profit and operating margin. For example, one investor commented that the current trend among consumer and industrial entities is to exclude depreciation and intangible asset amortization from COGS, which would improve gross margin. Additionally, a few investors raised concerns about earnings management using discretionary expenses and stated that the additional disaggregation of expense information could provide some visibility into potential distortions in earnings.
 - (c) *Comparable.* Some investors commented that having (i) the ability to compare different entities and (ii) consistent information to perform entity-specific trend analyses is critical in investment decisions and modeling. Disclosing the required

expense categories that are common across industries would allow investors to compare those expenses that may be presented differently by other entities. One investor noted that disclosing depreciation and intangible asset amortization would help compare gross profit across entities regardless of whether those expenses are included in or excluded from COGS.

How Investors Would Use the Information

18. Investors identified several ways in which they would use the disclosure of the required expense categories for each relevant expense caption:

- (a) *Forecasting.* Most investors said that they would be able to model forecasts at the expense level rather than make assumptions at the functional line-item level. Said differently, they noted that more precise valuation inputs and assumptions can be made based on the detailed expense information. Some investors said that greater transparency into variable costs such as inventory expense would help identify market price risk exposures and potential cash flows to offset the exposure. For example, they can perform sensitivity analyses to assess the effects of changes in economic factors on different types of variable expenses. A few investors commented that they also would have greater visibility into key expenses, such as employee compensation, that are incurred either to maintain current revenues or as investment spending that may create future revenues.
- (b) *Adjusting noncash items.* Some investors commented that separate disclosure of depreciation and intangible asset amortization is important because investors have different views about whether future cash flows are needed to replace tangible assets versus intangible assets. Specifically, those investors explained that depreciation is often linked to CAPEX spend while intangible asset amortization is viewed as a noncash expense. A few investors said that intangible asset amortization is the most common non-GAAP adjustment today, and the proposed amendments would make it easier for investors to exclude it from valuations and financial metrics.
- (c) *Relying on financial statements.* One investor observed that entities often discuss cost structure (for example, the percentage of raw materials in COGS) in earnings calls, but rarely disclose this information in financial statements filed with the SEC. This investor expects that the proposed amendments would make investors more interested in reading those filings and that detailed expense information may also be included in earnings releases eventually. Those comments and other feedback related to the mitigating effects of disaggregation on earnings management indicate

that the proposed amendments could result in investors relying more on information provided in financial statements rather than focusing more heavily on earnings release data.

- (d) *Comparisons.* Some investors said that they would use the required expense information for benchmarking purposes; that is, they would be able to compare an entity's expense information with similar entities to evaluate the performance of the entity or refine valuation estimates. One investor commented that his firm does a lot of peer-based analyses to evaluate the strength or productivity of different entities in which it invests. The required expense information could be easily incorporated into the firm's database to help compare margins across entities. Additionally, another investor commented that receiving consistent expense information over time for an entity would be critical to perform meaningful trend analysis and modeling.

Suggested Additional Expense Categories

- 19. Some outreach participants commented that the required expense categories could be further disaggregated into different components:
 - (a) *Employee compensation.* One investor stated that separately disclosing salaries and bonuses would be helpful because salaries are considered a fixed component of employee compensation and bonuses are considered a variable component. That investor noted that it is common for entities to manage earnings by adjusting the levels of bonus accruals and that incremental disclosure about the components of employee compensation could give some visibility into potential distortions in earnings.
 - (b) *Intangible asset amortization.* On one hand, some investors stated that separately disclosing amortization of acquired intangible assets and amortization of internally developed intangible assets would be useful. Those investors mentioned that some intangible asset amortization (for example, software amortization) is more like depreciation and, therefore, should be considered operating costs.¹ On the other hand, another investor said he generally looks through amortization expense and, instead, focuses on cash spend because it is more relevant and is not subject to estimates (for example, when determining the useful lives of intangible assets).

¹ GAAP currently requires that the amortization of certain types of intangible assets (for example, film costs) be disclosed separately from the amortization of intangible assets disclosed in accordance with Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill. Amortization of software costs that are capitalized in accordance with Subtopic 985-20, Software—Costs of Software to Be Sold, Leased, or Marketed, are subject to the disclosure requirements in paragraphs 350-30-50-1 through 50-3. Therefore, in some instances, investors may not have full visibility into amortization of acquired intangible assets and amortization of internally developed assets without an explicit requirement to separately disclose those amounts.

20. Investors also suggested additional expense or cost categories that are important to be disaggregated from functional expense line items, particularly from COGS. The complete listing of those suggestions is further discussed in Key Proposal 2 because most of them relate to costs incurred for inventory and manufacturing activities. Other expense categories suggested by a few investors are summarized as follows:
- (a) Expenses that may represent investments in the entity (for example, recruiting expenses or the components of research and development expenses).
 - (b) The disaggregation of foreign currency transaction gains and losses between working capital accounts and long-term accounts. One investor commented that his firm views those types of accounts differently and that separate disclosure would help his firm look through transaction gains and losses on long-term accounts.
 - (c) The disaggregation of research and development and technology spending of nontechnology entities. Additionally, one of the academic participants observed that separating research from development, either in presentation or in disclosure, would be beneficial because those activities are economically different.

Other Observations

21. During the interviews, outreach participants also made a number of other observations about the required expense categories:
- (a) *Competitive harm.* A few investors expected pushback from preparers for the proposed disclosure of employee compensation for competitive reasons. Additionally, one investor expected pushback from preparers on the suggestion to further separate salaries and bonuses, especially from entities with relatively higher bonuses in their compensation structures, such as banks.
 - (b) *Disclosure of total expense only.* One investor observed that some service companies and European companies tend to provide detailed operating expenses by nature without a breakdown of those expenses by functional lines. That investor commented that this approach could be a suitable alternative to meet investors' requests for more visibility into natural expenses but with less complexity. Specifically, he noted that some investors may be confused by the costs incurred approach to further disaggregate inventory and manufacturing expense as well as other aspects of the amendments in the proposed Update.
 - (c) *Inconsistency with requirements for not-for-profit entities.* The academic participants said the proposal is a "good starting point" but questioned why a more detailed natural expense disaggregation cannot be provided by business entities when not-

for-profit entities currently provide this information.² They commented that it is not intuitive that not-for-profit entities have more accessible disaggregated expense data than business entities.

Application of the Proposed Amendments to Banks

22. Some outreach participants and three bank investors who were contacted by the staff in connection with outreach calls for other projects commented on applying the amendments in the proposed Update to banks and other financial institutions that comply with the requirements in SEC Regulation S-X Rule 9-04.³
23. Investors provided mixed views on whether the proposed disaggregation of expense information would be useful for analyzing banks. Two investors welcomed applying the proposed amendments to banks. Two investors said that the proposals would not provide decision-useful information and, therefore, should not be applied to banks. They noted that banks already disclose employee compensation, inventory and manufacturing expense is either immaterial or not applicable for banks, and depreciation and intangible amortization generally are not meaningful for analyzing banks.
24. Most of the investors that provided feedback on the application of the proposed amendments for banks agreed that the disaggregation between depreciation and intangible amortization would be useful, including one investor who broadly commented that banks should be excluded from the scope. That investor noted that further disaggregation of amortization into amortization of core deposit intangible assets, bond premiums, and other intangible assets could be useful. A few investors also observed that having all required expense categories and other expense disclosures required by existing GAAP in one disclosure and having visibility into the composition of other expenses would be helpful.

Key Proposal 2: Further Disaggregation of Inventory and Manufacturing Expense

Why the Proposal Would Be Useful and How Investors Would Use the Information

25. All outreach participants⁴ supported the further disaggregation of inventory and manufacturing expense. The following details were provided about why the incremental disclosures would be useful and how investors would use the information:

² Paragraph 958-220-50-1(c) requires that a not-for-profit entity either present or disclose an analysis that disaggregates functional expense classifications by their natural expense classifications.

³ SEC Regulation S-X Rule 9-04 requires greater disaggregation of an entity's income statement as compared with commercial and industrial entities, including the separate presentation of salaries and employee benefits.

⁴ Excludes bank analysts.

- (a) *Enhanced transparency.* Investors stated that the further disaggregation of inventory and manufacturing expense would provide enhanced transparency and improve their abilities to understand an entity's business. One investor noted that the proposed disclosure would provide the information needed to verify management's explanations for increases in certain account balances (for example, inventory and accounts payable). Moreover, some investors stated that this information would allow them to ask management more informed questions.
- (b) *Benchmarking.* Investors observed that the costs incurred approach would provide comparability in peer analyses for gross margin, inventory growth, and capitalization rates. One investor noted that the inventory purchases category would allow him to compare the disclosed amount with his own forecasted amounts, which would enhance the accuracy of his inventory assumptions. A few investors noted that the further disaggregation would allow for better benchmarking across entities for both gross margin and disclosures about inventory.
- (c) *Forecasting cost movements.* Other investors commented on having insight into commodity and raw material exposure, which would provide a better understanding of an entity's risk exposure and the pricing structure needed to offset headwinds. A few investors expressed appreciation for the ability to (i) more accurately analyze the cost movements of an entity and (ii) better estimate the drivers of volatility. For example, one investor stated that if two manufacturers have similar total costs, but the cost components of the entities change in a dissimilar manner, then he would assess the performance of those entities differently.
- (d) *Cash flow information.* Most investors stated their preferences for the costs incurred approach when further disaggregating inventory and manufacturing expense because that approach provides information that better aligns with the cash flows for the period and provides more relevant information.

Additional Cost Categories and Other Suggestions

Additional Cost Categories Suggested for the Disaggregation of Inventory and Manufacturing Expense

- 26. Investor outreach participants identified the following additional cost categories that would be useful when further disaggregating inventory and manufacturing expense:
 - (a) *Utilities and energy.* A few investors commented that having visibility into utility and energy spend would be useful for their analyses of the fixed and variable cost components of inventory and manufacturing expense. Additionally, one investor explained that this disclosure would be beneficial for investors due to the changing

economic environment (for example, increased natural gas and oil costs in Europe during 2022 and 2023).

- (b) *Freight.* Some investors noted that having visibility into freight costs would be useful to understand how the transportation of goods affects the cost of inventory. One investor noted that transportation costs significantly increase when ports have issues (for example, port labor strikes).
- (c) *Packaging.* One investor commented that packaging costs are significant for certain entities (for example, beverage manufacturers). Specifically, the investor noted that the cost of packaging is generally higher than the raw materials and other ingredients used in the product and, therefore, visibility into this cost would provide investors with decision-useful information.
- (d) *Commodities.* Several investors recommended separately disclosing the costs of raw materials and commodities to help them understand the sensitivity of COGS to those different risk exposures. One investor noted that having detail around the type of commodity, such as copper, oil, or coal, would be meaningful.
- (e) *Provisions (or allowances) on inventory.* One investor stated that disclosing the amounts of all provisions would be very helpful because they are estimates and, therefore, could be leveraged by entities for purposes of earnings management.

Other Suggestions for the Application of the Costs Incurred Approach

27. Some investors suggested disclosing (a) the total amounts of costs incurred for the required cost categories (for example, total employee compensation cost incurred by an entity) and, in some instances, (b) the further disaggregation of those costs incurred between those that are capitalized and those that are expensed as incurred during the period. One investor acknowledged that without this information the disclosures of employee compensation would be “incomplete.” Similarly, another investor expressed concern that many investors may misunderstand the fact that the proposed disclosures of employee compensation would not reflect total employee compensation cost incurred during a period. Specifically, that investor stated that employee compensation costs capitalized into assets other than inventory (such as software, film assets, and costs to obtain a contract with a customer) would not be disclosed when incurred and would be reflected as a component of amortization expense when those assets are subsequently measured.⁵ The investor stated that this aspect of the proposed amendments might cause

⁵ Paragraph 220-40-55-3 states that an entity is not required to disaggregate the depreciation and amortization of assets (for example, property, plant, and equipment and costs to fulfill a contract with a customer) into the required expense categories.

concern within the investor community because total employee compensation for the period would not be disclosed.

28. Additionally, one investor and one academic participant requested that software be subject to the costs incurred approach because software is generally a significant asset for many entities. The academic participant commented that, currently, investors do not receive adequate information about technology expenditures in total and, more specifically, the cost components of those expenditures. The investor stated that for entities that incur software costs, applying the costs incurred approach to software would be more useful than applying that approach to inventory and manufacturing expense because a significant portion of an entity's employee compensation cost incurred during a period is generally for the development of software. However, the investor acknowledged that similar challenges that would be encountered when further disaggregating inventory and manufacturing expense would likely exist when further disaggregating software costs.

Other Observations

29. Two investors commented that the further disaggregation of inventory and manufacturing expense could be illustrated as an inventory rollforward. One of those investors also recommended disclosure about the assumptions that management makes when determining costs to be capitalized into inventory, which could complement the proposed disclosure because it would allow this investor to better understand if management was "more aggressive with cost capitalization" as compared with prior periods.
30. One investor questioned how the costs incurred for the acquisition of inventory through a business combination or asset acquisition would be presented in the proposed disclosure, stating that it was important to have that specific information.

Key Proposal 3: Disclosure of Selling Expense

Disclosing Total Selling Expense

31. All investors supported the proposed selling expense disclosure requirements. They noted that, regardless of whether selling expense is separately presented on the face of the income statement, additional disclosures about selling expenses would be helpful.⁶ Specifically, they explained that the proposed disclosure of selling expense would allow investors to:

⁶ Paragraphs 220-40-50-4 and 220-40-50-10 would require that selling expense be subject to disaggregation if it is a relevant expense caption, that is, if it is presented as an expense caption on the face of the income statement and contains at least one of the required expense categories. If selling expense is combined with other expenses (for example, general and administrative (G&A) expense) on the face of the income statement, paragraph 220-40-50-22 would require disclosure of total selling expense recognized during the period without additional disaggregation.

- (a) Develop and analyze trends in selling expense and assess those trends in relation to revenues.
 - (b) Differentiate between selling expense (which some investors explained are generally viewed as variable expenses) and general and administrative (G&A) expense (which some investors described as fixed overhead expenses), when selling expense is presented with G&A expense on the face of the income statement.
32. Some investors suggested further disaggregating selling expense into some or all of the required expense categories and other suggested expense components. Two of those investors specifically suggested disclosing employee compensation and advertising expenses so that investors can have greater visibility into the fixed and variable components of selling expense. Specifically, those investors explained that it would be helpful to understand expenses incurred on discretionary marketing activities and amounts incurred for employee compensation and other investments within the selling function that may contribute to additional future revenue.
33. One investor requested that capitalized commissions (that are then amortized into selling expense) be subject to the costs incurred approach because it would enhance his view of current period expenditures. Specifically, this investor explained that entities in the technology industry often pay commissions and other similar fees to secure long-term customer contracts that are capitalized and subsequently amortized over the customer relationship. This investor explained that, as a result, the selling expense recognized would not closely align with current period cash flows.

Defining Selling Expense

34. Most investors that commented on this proposed requirement supported the Board's tentative decision to require that an entity disclose how it defines selling expense, stating that consistency of an entity's definition of selling expense across multiple periods would be more useful than consistency across entities if the Board defined selling expense.
35. Additionally, some of those investors commented that an entity should develop its own definition of selling expense because it would be difficult for the Board to develop a definition that would be relevant for all industries. Those investors explained that they would expect entities in the same industry to have similar definitions. However, two investors suggested that the Board provide "guidelines" to avoid boilerplate disclosure.
36. Some of those investors that supported the proposed requirement were concerned about situations in which an entity changes its definition of selling expense during the period and the extent to which those changes would be disclosed. For example, one investor stated the importance of an entity disclosing a change in its definition of selling expense in the

period the change occurs so that investors can account for that change in their analyses in a timely manner.

37. One investor preferred that the Board define selling expense to ensure comparability and to limit the risk of entities avoiding or providing inadequate disclosure of selling expense.

Key Proposal 4: Qualitative Disclosure of Other Items and Integration of Existing Disclosures

Qualitative Disclosure of Other Items

38. Some investors commented that the qualitative description of other items (also referred to as the “residual”) is helpful for their analyses and understanding of the expense components. For example, one investor stated that it would provide insights into certain expense categories that he otherwise would prefer to have separately disclosed (for example, transportation and logistics expenses) after disaggregating the required expense categories.
39. A few investors noted that further disaggregating the residual would be more helpful and asked whether a quantitative threshold would be more informative than the narrative description. For example, one investor suggested separate disclosure of any expenses that exceed 20 percent of the total expense caption. Two academic participants questioned whether the residual would be significant after the disaggregation of the required expense categories and, therefore, suggested that the Board reconsider using a quantitative threshold for further disaggregation. For example, one academic participant suggested the disaggregation of any expense that is greater than 1 percent of revenues, while the other academic participant commented that a 5 percent threshold may be more appropriate. Both asserted an expectation that entities already have the information, so there should not be significant costs incurred to further disaggregate expense captions.

Integration of Existing Disclosures

40. Most investors commented that the integration of existing disclosures would provide relevant information for their analyses, reduce the time it would take to find the disclosure of these items elsewhere in the notes to financial statements, and reduce the residual amounts that remain after the disaggregation of the required expense and cost categories.
41. Some investors initially interpreted that the proposed amendments would require that an entity provide the disclosure regardless of materiality. After the staff clarified that the proposed requirement is not intended to override materiality conclusions made by management with respect to the disclosure of those amounts, a few of the investors noted

that the proposed requirement is not as useful because the amounts, if material, are currently disclosed in the footnotes.

42. One investor recommended that the Board consider implementing a mapping requirement for the expenses, gains, and losses that are listed in paragraph 220-40-50-13.⁷ He explained that it would be helpful to understand whether those amounts are included in one expense caption or multiple expense captions on the income statement.

Other Aspects of the Proposed Update

Disclosure Frequency

43. Investors strongly supported the requirement to provide the disclosures on an interim basis. Many investors stated that the benefits of the amendments in the proposed Update would be diminished substantially if the proposed disclosures were provided only on an annual basis. For example, multiple investors mentioned that quarterly trends are important for the core expense line items and, without having the information quarterly, the modeling process would be very challenging. Two investors noted that the disclosure would provide limited use if required only in annual reporting periods because of the lag in receiving the information. That is, investors would not receive updated expense information for the current year until the first quarter of the following year when the corresponding annual financial statements are issued.
44. One investor did not feel strongly about having the information at interim periods because that investor takes a “long-term” perspective and, therefore, is less concerned about expense fluctuations at interim periods. As such, that investor would likely exclude interim expense information from its analysis. However, that investor acknowledged the usefulness of providing additional expense information at interim periods for the broader investor community.

Transition Method

45. Most investors supported prospective transition with optional retrospective application. Those investors stated that while retrospective application is generally preferred, the proposed amendments would not affect profit and loss in prior periods. Therefore, they would prefer prospective transition to allow for an earlier effective date of a final Update.

⁷ Paragraph BC73 states that the Board acknowledges that current GAAP does not require that an entity disclose the income statement caption in which those expenses are recorded. Therefore, the Board also decided to require that an entity incorporate those expenses in the proposed tabular format disclosure only when those expenses are entirely recognized in one expense caption that also is a relevant expense caption.

46. A few investors stated that while they supported prospective transition, they would prefer that an entity provide at least one year or, at a minimum, one quarter of comparative information. Those investors stated that having comparative information would allow for benchmarking and increase the decision usefulness of the information in the year of adoption.

Other Feedback

47. Outreach participants provided the following additional observations and suggestions, some of which relate to items that are outside the scope of the proposed Update:
- (a) *Interaction with segment reporting.* Two academic participants stated that information about the required expense categories would be more useful if it was incorporated into an entity's segment disclosure rather than only disclosing that information at the consolidated level. One investor stated that "coordinating" the proposed Update with Accounting Standards Update No. 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures*, would be useful because, otherwise, it would be challenging if the disaggregated expense amounts do not reconcile to expense amounts disclosed in the segment footnote.⁸
 - (b) *Requests for detailed human capital information.* Two academic participants requested disclosure of human capital metrics but acknowledged that that information may be better suited in other sections of SEC filings (for example, management's discussion and analysis of financial condition and results of operations), rather than in the financial statements and footnotes. The participants noted that requiring the disclosure of the number of employees by type (for example, full-time, part-time, or contingent) would be useful because they would be able to link headcount by type to employee compensation.

Comment Letter Summary on the Proposed Accounting Standards Update on Disaggregation of Income Statement Expenses

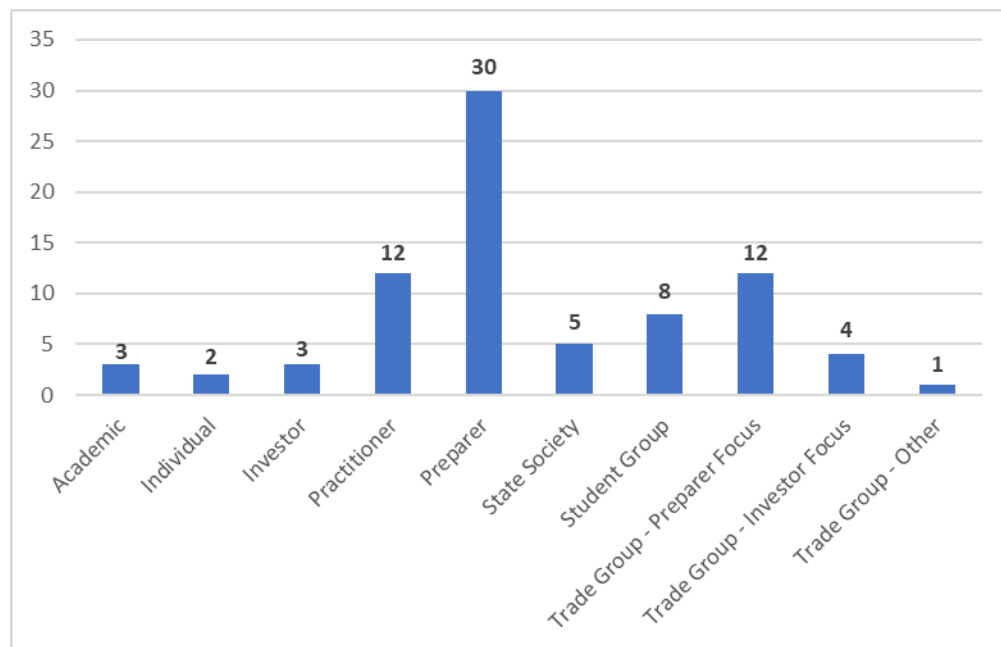
48. The purpose of this summary is to provide a summary of the feedback received on the proposed Update from comment letter respondents. The proposed Update was issued for public comment on July 31, 2023, with comments due by October 30, 2023.

⁸ Update 2023-07 requires that an entity disclose significant segment expenses that are (a) regularly provided to the chief operating decision maker and (b) included in the measure of segment profit or loss.

49. This comment letter summary is structured as follows:
- (a) Overview on Comment Letter Feedback
 - (b) Issue 1: Expense Captions Subject to Disaggregation Requirements
 - (c) Issue 2: Entities within the Scope
 - (d) Issue 3: Required Expense Categories
 - (e) Issue 4: Further Disaggregation of Inventory and Manufacturing Expense
 - (f) Issue 5: Integration of Existing Disclosure Requirements
 - (g) Issue 6: Qualitative Description of Other Items
 - (h) Issue 7: Selling Expenses
 - (i) Issue 8: Interim Reporting
 - (j) Issue 9: Transition and Effective Date
 - (k) Other Feedback.

Overview on Comment Letter Feedback

50. The Board received 80⁹ comment letters on the proposed Update from the following stakeholders:



⁹ The Board received 80 letters because there are 2 letters marked as #5 (#5 and #5A), both of which were submitted by student groups from different classes of the same university.

51. The following categorization was used:
- (a) “Preparer” includes individual public companies.
 - (b) “Practitioner” includes accounting firms.
 - (c) “Trade Group—Preparer Focus” includes both (i) industry organizations and (ii) groups that represent multiple preparers or practitioners.
 - (d) “State Society” includes state CPA societies.
 - (e) “Investor” includes individual investors.
 - (f) “Trade Group—Investor Focus” includes investor-oriented organizations.
 - (g) “Academic” includes individuals from the academic community and organizations largely made up of academics.
 - (h) “Student Group” includes classes of undergraduate or graduate university students.
 - (i) “Individual” includes individual respondents with experience working as preparers.
 - (j) “Trade Group—Other” includes groups that represent multiple preparers, practitioners, and other stakeholders.
52. In addition to the comment letters received from investors, the staff interviewed 19 investors and 2 academics to supplement comment letter feedback. Feedback from those interviews is included in the [investor feedback summary](#).
53. Overall, feedback from respondents on the amendments in the proposed Update was mixed. Many comment letter respondents generally supported the Board’s efforts in this project and the project’s objectives. Some comment letter respondents stated that the required disclosures would provide investors with decision-useful information. Broadly, preparers and other respondents expressed concerns about operability challenges and costs to implement the proposed amendments and questioned whether the benefits of the information resulting from the proposed amendments would justify the expected costs.
54. Both respondents that supported and did not support the proposed Update provided suggestions on various areas for further improvement or clarification. Those suggestions are included throughout this summary in the relevant sections.

Issue 1: Expense Captions Subject to Disaggregation Requirements

Background

55. The proposed Update includes the following question:

Question 1: The amendments in this proposed Update would require that a public business entity disclose disaggregated relevant expense captions in the notes to financial statements. For preparers and practitioners, are the proposed amendments for identifying relevant expense captions operable? Please explain why or why not. If not, what changes would you make?

56. An expense caption is a relevant expense caption that:
- (a) Is presented on the face of the income statement within continuing operations
 - (b) Contains at least one of the required expense categories that are addressed in Issue 3 of this summary.

Comment Letter Feedback

57. Forty-one respondents commented on the operability of identifying relevant captions. Most respondents stated that the proposed guidance is operable, while some respondents either stated that it is not operable or expressed neutrality on the issue.
58. Most comment letter respondents that provided feedback on this question generally agreed that the guidance for identifying relevant expense captions is operable because:
- (a) *The guidance is clear.* Several respondents commented that describing relevant expense captions as those that contain any of the required expense categories is sufficiently clear or appropriate. Also, one preparer said that by defining a relevant expense caption as, in part, a caption presented on the face of an entity's income statement, a preparer has a clearly defined population on which to begin identifying relevant expense captions. Furthermore, another preparer noted that detailed illustrative examples in the proposed Update clearly illustrate how the proposed amendments should be applied and operated. Lastly, an academic respondent noted that the definitions for expenses such as employee compensation, inventory expense, and manufacturing expense are clear, which should further support the operability of the proposed amendments.
 - (b) *The guidance is flexible.* One practitioner supported the Board's decision not to identify specific expense captions for disaggregation, given the inconsistency of expense captions between entities. Another practitioner acknowledged that not prescribing the form and content of income statement expense captions represents a practical and meaningful step toward providing a more detailed breakdown of an entity's expenses but commented that diversity in practice in how entities present expense captions within and across varying industries is expected to continue.

- (c) *Relevant expense captions are easy to identify.* A preparer-focused trade group and several preparers noted that most entities could easily identify relevant expense captions or have a limited number of relevant expense captions subject to disaggregation. For example, one preparer said, as a manufacturing entity, its relevant expense captions are primarily cost of sales and SG&A. A practitioner noted that the expense categories used to identify relevant expense captions are easy to identify and are frequently already subject to measurement and disclosure requirements in GAAP, and, thus, this familiarity with those expense categories will enable their identification within expense captions. Similarly, one academic respondent stated that identifying relevant expense captions as those captions that contain any required expense categories should be rather straightforward.
59. However, some of those respondents stated that the guidance for identifying relevant expense captions is operable once entities allocate the resources necessary to update systems and develop appropriate controls and procedures. Additionally, many respondents provided suggestions as further summarized in the following sections.

Exemptions and Practical Expedients

60. Some preparers and a trade group from the insurance industry requested excluding certain expense captions from the disaggregation requirements, as follows:
- (a) Two respondents stated that direct selling expenses related to the acquisition of an insurance contract should be excluded from the scope of these disclosure requirements because specific accounting guidance exists for those expenses.
 - (b) Another respondent recommended excluding claim and claim adjustment expenses accounted for in Topic 944, Financial Services—Insurance, from the scope of the proposed Update, citing that it does not see any benefit of disaggregating those expenses.
61. In addition, several respondents requested practical expedients or exemptions from the disaggregation requirements:
- (a) One preparer requested providing an exemption from the disaggregation requirement of a given line item if an entity determines that it is impracticable to deconstruct the data (for example, because of systems limitations, undue effort, or concerns about data integrity).
 - (b) One practitioner suggested allowing an entity to disclose qualitative information about the nature of a relevant expense caption when substantially all of that caption consists of one required expense category. The respondent further noted that the

term “substantially all” is an existing concept in GAAP that is interpreted to mean 90 percent or more.

- (c) One preparer and one preparer-focused trade group requested allowing (i) oil and gas entities that report purchases of inventory on the face of their income statements to have satisfied the proposed disclosure requirement of inventory and manufacturing expenses and (ii) vertically integrated companies that present or disclose a combined amount for depreciation, depletion, and amortization recognized as part of oil- and gas-producing activities (DD&A) to disaggregate it based on the nature of operations of the entity. Specifically, that preparer suggested that DD&A be disaggregated into two categories: oil- and-gas related depletion and a combined amount for depreciation and amortization of long-lived assets that are not within the scope of Topic 932, Extractive Activities—Oil and Gas. The trade group and another preparer further suggested that oil and gas entities rely on the current supplemental disclosures of oil and gas activities to satisfy the proposed disclosure of DD&A.

Clarifications

62. Comment letter respondents provided various suggestions to clarify the guidance on identifying relevant expense captions, as follows:

- (a) *Materiality.* Several respondents provided the following feedback or suggestions on the application of materiality to the proposed amendments:
 - (i) One preparer expressed concerns that an expense caption would be subject to disaggregation if it contains *any* amount of one of the required expense categories. That respondent further noted that without regard to materiality, an entity would inevitably have large balances classified as “other items” in the expense disaggregation disclosures with immaterial balances comprising both inventory and employee compensation expenses.
 - (ii) Three preparer-focused trade groups recommended clarifying or explicitly stating that materiality applies to all proposed disaggregation requirements and that those requirements need not be applied to immaterial items. Similarly, one practitioner suggested clarifying how the materiality requirement in paragraph 105-10-05-6 interacts with the proposed amendments.
 - (iii) One preparer suggested that the Board include implementation guidance for the level at which materiality should be assessed (for example, the amount of a required expense category within each relevant expense caption or the

amount of a required expense category in total) and provided examples that illustrate the need for that guidance.

- (iv) Three respondents suggested introducing a materiality threshold for expense disaggregation (for example, a required expense category that is less than 10 percent of the expense caption need not be disaggregated). Two of those respondents noted that disaggregating insignificant expense categories would not provide decision-useful information.
 - (v) One preparer-focused trade group suggested considering both qualitative and quantitative guidelines to identify relevant expense captions, noting that a “one size fits all” proposal, regardless of industry, may not be beneficial for investors in entities across all industries.
- (b) *Asset and liability captions.* Two respondents requested that the Board clarify that employee compensation included in assets other than inventory and liabilities would not be subject to disaggregation requirements. One of those respondents noted that paragraph BC107 of the proposed Update clarifies that employee compensation costs associated with capitalized internal software costs would not be subject to the proposed amendments. This respondent requested that similar clarification be extended to employee compensation costs associated with other balances common to life insurance entities, including (i) primarily investment-related activities (including those presented in net investment income), (ii) deferred acquisition costs, and (iii) sales inducements and claim adjustment expenses that have been included in the liability for claim adjustment expense or the liability for future policy benefit balances. Another respondent provided similar examples in other Topics and encouraged the Board to consider expanding the guidance in paragraph BC107 of the proposed Update to address those examples. That respondent also recommended clarifying that accruals associated with liabilities that would be fulfilled by employees would not be identified as a relevant expense caption.

Other Feedback

63. Two respondents raised concerns about an unintended consequence of the proposed amendments related to the level of disaggregation in the income statement. One student group commented that entities may be incentivized to present fewer expense captions on the face of the income statement; that is, an entity that voluntarily reports certain expense captions may discontinue that practice so that it would be subject to fewer disaggregation requirements. Similarly, one preparer stated that an entity might choose to collapse its activity in the income statement to simplify the disaggregation required by the amendments

in the proposed Update. That respondent noted that this potential unintended consequence would reduce decision usefulness because investors would lose visibility into a more meaningful income statement presentation.

Issue 2: Entities within the Scope

Background

64. The proposed Update includes the following question:

Question 2: Should the proposed amendments apply to all public business entities? Please explain why or why not?

Comment Letter Feedback

65. Forty respondents commented on the proposed scope. The majority of respondents agreed that the proposed amendments should apply to all public business entities while some respondents either disagreed or expressed neutrality on the issue.

66. Most comment letter respondents that explicitly expressed views on this question agreed that the proposed amendments should apply to all public business entities and provided the following reasons:

- (a) *Relevance.* Most respondents that supported the proposed scope cited that the proposed disclosures would broadly benefit all investors. One student group noted that applying the proposed amendments to all public business entities is appropriate because most expense categories required to be disaggregated appear to be natural expenses that any public entity may incur over the course of its operations. Also, an academic stated that the required scope would more fully address investors' demands for transparent disaggregated expense information and would better respond to regulators' preferences for uniformity in disaggregation practices across public business entities. Additionally, two preparers said that because the project's objective is to provide investors with decision-useful information, they did not identify any particular reason why investors in certain public business entities should not receive such information. Similarly, one state society noted that it did not identify any subset of public entities that should be excluded from the scope, and a preparer said that it would be difficult to define a class of public business entities that should be exempt from the proposed Update.
- (b) *Comparability.* Several respondents said that applying the proposed amendments to all public business entities would enhance comparability. One practitioner agreed that the proposed amendments should apply to all public business entities to

promote consistent disclosure practices across all public business entities and comparability in financial reporting.

67. One preparer that disagreed with the scope of the proposed Update stated that the proposed amendments should not be applicable for any entities.
68. Many respondents provided other feedback and various suggestions, as further summarized in the following sections.

Smaller Reporting Company Exemption

69. Four student groups and one practitioner requested that smaller reporting companies (SRCs), as defined by SEC Regulation S-X Rule 8-01, be excluded from the scope of the proposed Update. Three student groups cited the financial burden as a reason to exclude SRCs from the proposed Update, including systems changes. One practitioner noted that SRCs are exempt from many of the SEC's presentation and disclosure requirements, and the advantages of those exemptions would be greatly diminished if those entities were subject to the proposed amendments.

Specialized Industry Exemption

70. Several respondents questioned whether the proposed amendments are necessary for entities in certain industries, given existing industry-specific disclosure requirements:
 - (a) *Banking.* One preparer and one preparer-focused trade stated that the proposed amendments would not provide decision-useful information for investors of banking entities because their income statements are already disaggregated in accordance with current industry-specific guidance. Specifically, one of those respondents noted that SEC regulations already set forth robust disaggregation and disclosure requirements tailored to the banking industry. It further recommended that the SEC establish industry-specific disaggregation and disclosure requirements that are more streamlined and cost-effective. While respondents appreciated the practical expedient related to the employee compensation disclosure for banks, they noted that the Board could go further by providing an exemption.
 - (b) *Investment companies.* One practitioner recommended that the Board exclude investment companies from the scope of the proposed Update because those entities are subject to disaggregation requirements under Topic 946, Financial Services—Investment Companies, and Article 6 of SEC Regulation S-X.
 - (c) *Insurance.* Two insurance entities noted the recent expansion of disclosure requirements introduced by Accounting Standards Update No. 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for*

Long-Duration Contracts. Accordingly, those entities stated that the proposed amendments would not provide additional meaningful information that would be considered necessary to evaluate the performance of a life insurance entity, both period over period and with that of other life insurance entities. Another insurance entity stated that the most meaningful information for investors of property casualty insurers is currently provided outside the financial statements, such as in earnings supplements and press releases. Additionally, that respondent expressed concerns that the proposed expense disaggregation disclosures would present investors with “unnecessary noise.”

- (d) *Oil and gas.* One preparer noted that oil and gas entities comply with SEC Regulation S-X Rule 5-03, Statement of Comprehensive Income, Topic 932, and SEC Rule 4-10 of Regulation S-X, all of which result in those entities presenting or disclosing more information than public entities in other industries. That respondent recommended that the Board create separate industry guidance for manufacturing entities, including the requirements to disclose income statement disaggregation with a necessary scope exemption for entities operating in resource extraction industries.
- (e) *Broker-dealers and other similar industry practices and requirements.* One practitioner recommended that the Board consider whether prevailing industry-specific presentation practices or requirements might exist to meet investors’ needs without adding the proposed disaggregation disclosures. For example, it noted that broker-dealer entities already report various expenses on the face of the income statement. That respondent questioned whether the proposed disaggregation requirements might lead to redundant or unnecessary information being disclosed by similar entities.

Definition of Public Business Entities

71. Several practitioners provided comments about entities captured by the public business entity definition that they requested be removed from the scope. Additionally, as noted by one practitioner, the definition of a public business entity as used in the proposed Update would include within its scope private companies whose financial statements are or financial information is included in the filings of another public business entity when required by certain SEC rules, such as Regulation S-X, Rule 3-05 and Rule 3-09. Those respondents proposed the following scoping suggestions:

- (a) Two practitioners requested that the Board clarify whether a public business entity that otherwise would not meet the definition of a public business entity except for a requirement to include, or the inclusion of, its financial statements or financial

information in another entity's filing with the SEC should be within the scope of the proposed Update. One of those respondents noted that it might be challenging for those entities to prepare the proposed disclosures for all required periods.

- (b) One practitioner encouraged the Board to consider redefining the scope of the proposed Update to apply only to public entities and not to public business entities, consistent with the scope of Topic 280, Segment Reporting. That respondent explained that private companies may have significant challenges providing the disclosures required by the proposed Update because they are not likely to have the information systems and data-gathering capabilities in place to generate them, particularly under the SEC reporting deadlines. Similarly, another practitioner recommended that nonissuer public business entities be exempt from the proposed Update, noting that the cost of implementing processes, controls, and infrastructure necessary to maintain this level of data may be onerous relative to the amount of value that it may provide to a subset of investors.
- (c) One practitioner recommended that the Board undertake a separate project to reassess the appropriateness of the public business entity definition for purposes of differentiating the applicability of its standards, questioning the usefulness of the proposed disclosures for nonissuer broker-dealers and similar closely held entities that meet the definition of a public business entity.

Deferrals for Certain Entities

72. Two practitioners and one preparer suggested that the Board consider providing temporary on-going relief (for example, a one-year deferral from the date of acquisition) for acquired businesses that otherwise would not have been included within the scope of the amendments prior to the acquisition. One of those respondents explained that it may otherwise be difficult for such an acquired business to implement the necessary systems, processes, and controls to produce the proposed disclosures within one interim period. Additionally, one of those practitioners suggested that similar relief be provided for entities entering the public markets through an initial public offering or other transactions. That respondent explained that those entities may find it "cost-prohibitive or even impossible to enter the public markets if...the disclosures are required for all periods included in the initial registration statement."

Issue 2A: Nonpublic Entities

Background

73. The amendments in the proposed Update would not apply to private companies, not-for-profit entities, or employee benefit plans. The Board's rationale for excluding nonpublic entities from the scope of the proposed Update is summarized in paragraphs BC20 through BC25.
74. The proposed Update did not include a question on excluding nonpublic entities from the scope. Nonetheless, respondents commented on the issue, as summarized below.

Comment Letter Feedback

75. Fourteen respondents commented on whether the proposed amendments should apply to nonpublic entities.
76. Many respondents supported excluding nonpublic entities from the scope of the proposed Update. Four of those respondents agreed with the rationale provided in paragraphs BC22 through BC24. One practitioner noted that private company investors generally have close relationships with management. One state society stated that it would not support extending the proposed disaggregated expense requirements to entities that do not meet the definition of a public business entity.
77. Conversely, some respondents requested that the proposed amendments apply to private companies and provided the following reasons:
- (a) Four investor-oriented trade groups (and one academic respondent emphasized the need for disaggregated expense information for private market investors. One of those respondents expressed concerns about the lack of transparency in private companies' financial statements because a broad range of investors are now exposed to private markets directly or indirectly. Similarly, one of those respondents commented that only controlling shareholders would have broad access to information and management directly with any regularity and accounting standards should provide for a minimum level of decision-useful information for noncontrolling investors. That respondent further emphasized that investors in private and public business entities have the same informational needs.
 - (b) A few preparers supported applying the proposed Update to private companies. One of those respondents explained that including private companies within the scope would help an entity integrate acquisitions of nonpublic business entities more efficiently. That respondent further noted that it expects that the cost to comply with the proposed Update by smaller, less complex nonpublic business entities would be less than the costs for larger, more complex public business entities.

Issue 3: Required Expense Categories

Background

78. The amendments in the proposed Update would require that an entity disclose the following expense categories that are included in each relevant expense caption:
- (a) Inventory and manufacturing expense
 - (b) Employee compensation
 - (c) Depreciation
 - (d) Intangible asset amortization
 - (e) DD&A.
79. The proposed amendments include either new or amended Master Glossary definitions for some required expense categories: inventory expense, inventory and manufacturing expense, employee, and employee compensation. Additionally, the proposed amendments link depreciation and intangible asset amortization to existing disclosure requirements in Subtopic 360-10, Property, Plant, and Equipment—Overall, and Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill, respectively.
80. The sub-issues that will be addressed in this issue are as follows:
- (a) Issue 3A: Decision Usefulness of the Disaggregated Expense Information Provided to Investors
 - (b) Issue 3B: Operability and Costs of the Disaggregated Expense Information—Preparers
 - (c) Issue 3C: Proposed Definitions and Links to Other Guidance.

Issue 3A: Decision Usefulness of the Disaggregated Expense Information Provided to Investors

Background and Comment Letter Feedback

81. The proposed Update includes the following question:

Question 3: The proposed amendments would require that an entity disclose the amounts of (a) inventory and manufacturing expense, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) DD&A that are included in each relevant expense caption. For investors, would this proposed disclosure provide decision-useful information? If so, how would that information be used? If not, what changes would you make? Would any of the proposed categories not provide decision-useful

information? For example, are there categories that would be more decision useful than the ones being proposed?

Feedback on Decision Usefulness of the Proposed Amendments

82. Several respondents broadly stated that the proposed amendments would provide investors with decision-useful information, citing similar reasons as those provided by investor outreach participants. Two investor-oriented trade groups specifically supported the disclosure of employee compensation, stating that such information is critical to understanding an entity's human capital management practices and investments to attract and retain talent.
83. A few respondents expressed some support for the proposed amendments. One student group questioned whether separate disclosure of depreciation, intangible asset amortization, and DD&A would enhance investors' decision-making and commented that the separate disclosure of those amounts may potentially "distract them from more pertinent information." Similarly, two investors and one student group did not support all the required expense categories in the proposed amendments. One of those respondents stated that the proposed amendments regarding employee compensation "does not serve the purpose" stated in the proposed Update and questioned whether the disaggregation of depreciation expense would provide investors with decision-useful information. Additionally, another respondent stated that the proposed Update "falls short...because it provides a disaggregation of labor costs only and continues to aggregate materials and other costs into a few more line items." Those respondents provided suggestions for further disaggregation and other suggestions to improve the decision usefulness of the proposed amendments as described in paragraph 85 of this handout.
84. Although this aspect of Question 3 in the proposed Update was targeted toward investors, most preparer respondents across a broad range of industries, trade groups, and other stakeholder respondents expressed concern about the decision usefulness of the information that would be provided by the proposed amendments. Those respondents provided the following reasons to explain why the expected benefits of the resulting information may not justify the operability challenges and costs to implement the proposed amendments:
- (a) The required expense categories are not consistent with how an entity internally manages its costs and assesses its performance.
 - (b) Information about the required expense categories is not typically requested by an entity's investors and analysts.

- (c) The required expense categories do not adequately describe the major factors that affect an entity's performance.
- (d) Certain entities already disclose sufficient disaggregated expense information both voluntarily and in accordance with existing GAAP and regulatory requirements.
- (e) Existing income statement presentation guidance results in diversity in the presentation of income statement captions and the classification of expenses within those captions and, therefore, the disaggregated expense information may not be comparable.
- (f) The proposed amendments for employee compensation may not provide complete and comparable information.
- (g) Disclosure of depreciation and intangible asset amortization may not provide decision-useful information.
- (h) The proposed amendments may confuse investors.

Suggestions from Comment letter Respondents to Improve Decision Usefulness

85. Respondents (including respondents that supported the proposed amendments) provided suggestions to improve the decision usefulness of the proposed amendments for investors, as follows.

- (a) *Require a principles-based approach to expense disaggregation.* One of the two respondents that provided this suggestion also recommended that entities be allowed to determine and disclose disaggregated expense information that would better align with how management operates the business, monitors its expenses, and makes decisions.
- (b) *Add or replace required expense categories:*
 - (i) *Add utilities and energy.* One of the few respondents that provided this suggestion stated that energy costs are significant for many entities and, therefore, information regarding those costs would be useful for assessing future cash flows and how changing energy costs affect those cash flows. Additionally, that respondent suggested defining energy costs as “expenses associated with the use of all sources of energy including petroleum, natural gas, electricity, coal, nuclear, and renewable energy.”
 - (ii) *Add inventory obsolescence.* One of the two respondents that provided this suggestion explained that this information could provide insights into an entity's “research and development (R&D) accuracy and product market fit.”

- (iii) *Add professional services, supplies, and third-party software.* One respondent stated that most of these suggested expense categories are included as examples in the Master Glossary definition of natural expense classification that is linked to Topic 958, Not-for-Profit Entities.
 - (iv) *Add facilities and other occupancy costs.* One of the two respondents that provided this suggestion specifically suggested combining facility-related rent, depreciation, and amortization of right-of-use assets in a single expense category. Accordingly, that respondent suggested excluding those amounts from the depreciation and intangible asset amortization expense categories.
 - (v) *Replace the existing required expense categories with (1) cost of inventory consumed/sold, (2) labor for both employees and external contractors, and (3) other manufacturing/production costs.*
- (c) *Expand the definition of employee compensation to include amounts for part-time employee labor costs, temporary employee labor costs, contract labor costs, and other costs of an entity's workforce.* One of the few respondents that provided this suggestion explained that investors need compensation information for an entity's entire workforce, citing three Fortune 500 entities whose "material workforce" is made up of individuals that are not designated as employees. Another respondent suggested providing entities with an option to include consultant expenses within employee compensation to provide further insights into outsourced and co-sourced workforce models.
- (d) *Further disaggregate employee compensation into different forms of compensation.* Some respondents suggested further disaggregation of employee compensation into categories such as salaries, bonuses, commissions, payroll taxes, benefits, overtime, severance payments, retention bonuses, stock-based compensation, and retirement benefits. Those respondents explained that it would provide investors with insights into fixed versus variable and cash versus noncash components of employee compensation. One of those respondents also explained that different forms of compensation have different drivers that are relevant for evaluation and modeling. Additionally, one practitioner recommended separately disclosing special or contractual termination benefits recognized in accordance with Topic 712, Compensation—Nonretirement Postemployment Benefits, and Topic 715, Compensation—Retirement Benefits, because of the similarities to one-time termination benefits within the scope of Topic 420, Exit or Disposal Cost Obligations.

- (e) *Include qualitative disclosures about employee compensation.* One practitioner recommended additional qualitative disclosures about employee compensation because (i) the mix of employee compensation and consideration paid to contractors may vary significantly from one entity to another and (ii) it would help investors understand the extent to which employee compensation costs are capitalized and those that are expensed as incurred.
- (f) *Combine depreciation, depletion, and intangible asset amortization into one required expense category.* Three of the few respondents that provided this suggestion commented specifically on combining depreciation and amortization. One of those respondents stated that separately disclosing those amounts would not provide decision-useful information because they are both types of noncash expenses that operate in a similar manner. Another respondent stated that combining depreciation and intangible asset amortization would “accommodate the existing diversity” in entities’ depreciation and intangible asset amortization classification for certain types of assets.
- (g) *Replace DD&A with depletion and expand applicability to all relevant entities.* Two respondents (one of which operates in the extractive industry) expressed concern that the proposed amendments only address depletion recognized as part of oil- and gas-producing activities.
- (h) *Disclose total amounts for the five natural expense categories.* One of the few respondents that provided this suggestion explained that it would help investors identify when entities engage in expense reclassifications. Another respondent suggested disclosing total amounts on an incurred basis, which would provide information for both period costs and amounts capitalized into assets. One trade group did not suggest this alternative but noted that if the Board decides to pursue this alternative, some of its members noted that an entity should be required to reconcile the amounts disclosed for employee compensation to the respective income statement and balance sheet captions.
- (i) *Require the disaggregation of research and development (R&D) when combined with other expenses on the income statement (for example, SG&A).* Three respondents recommended disaggregating R&D expense because it would provide investors with information to better predict the amount, timing, and uncertainty of future cash flows stemming from investments in underlying R&D projects.

Issue 3B: Operability and Costs of the Disaggregated Expense Information—Preparers

Background and Comment Letter Feedback

86. The proposed Update includes the following question:

Question 4: For preparers, how does requiring disclosure of certain categories of expenses included in relevant expense captions compare with the operability and cost of requiring full disaggregation of income statement expenses into natural categories (including the disclosure of additional categories that would not be required by the proposed amendments)? Are there other broadly applicable expense categories or disaggregation approaches that would provide investors with more decision-useful information, be less costly to provide, or both? Please explain why or why not.

Feedback on Operability of the Proposed Amendments

87. Forty respondents provided feedback about the operability and cost of applying the amendments in the proposed Update. Some of those respondents specifically indicated that the proposed amendments would be more operable and less costly than a requirement to fully disaggregate income statement expenses into natural categories. One preparer-focused trade group explained that a full disaggregation of income statement expenses would result in significant incremental costs to preparers with limited benefits for investors. One preparer stated that a full disaggregation approach would require “considerable expansion of specified categories and associated definitions to support comparability across entities.” One preparer stated that it would expect costs to increase under a principles-based expense disaggregation approach.
88. Nearly all of the 40 respondents (which included all preparer respondents and other stakeholder types) expressed concerns about the operability and cost of applying the proposed amendments. Some of those respondents explained that the challenges faced by entities to comply with the proposed Update would vary widely across entities and would depend on many factors, such as the entity’s industry, the nature of the expenses that the entity incurs, the number of operating locations, the number and type of information technology systems in place, among others.
89. Many respondents explained that requiring classification of expense information by both function and nature is difficult because preparers have designed systems and reporting processes based on the expense captions required by SEC regulations. Therefore, in many cases preparers do not currently have the mechanisms to track or tag natural expenses to provide the proposed disaggregated expense disclosures. Those respondents explained that the proposed amendments likely would require significant and costly updates to

- preparers' existing enterprise resource planning (ERP) and/or consolidation systems, or implementation of new systems, in addition to the creation of new processes and internal controls over the proposed expense disclosures. For example, some respondents stated that preparers would need to develop sustainable processes for identifying the relevant source data at the local entity level, develop an account coding structure for data collection and reporting, implement internal controls over the financial reporting of the proposed amendments, and establish global training programs for employees. A few respondents stated that implementing the proposed amendments may require a significant amount of manual extraction from existing systems.
90. Additionally, several respondents explained that the proposed amendments would require a significant increase in human resources (either additional employees, support from third-party consultants, or both). Some respondents also stated that they would expect a significant increase in audit fees.
91. Even considering this feedback, some of those respondents generally indicated that certain operability challenges might be overcome with system and process enhancements and additional personnel (which may be substantial costs) and a sufficient period of time to implement a final Update (which is addressed in Issue 9 of this summary).
92. Regarding the general feedback noted above, many preparers and other stakeholder respondents raised the following specific concerns about the proposed amendments, many of which relate to broad operability and cost challenges, as follows:
- (a) Cost center allocations and intra-entity¹⁰ transactions limit or restrict visibility into the natural classification of expenses.
 - (b) The effect of foreign currency transactions would create challenges, especially in cases for which source data is in a different currency than the currency used for general ledger reporting.
 - (c) Entities with decentralized finance functions and/or multiple ERP systems track expense information differently across locations.
 - (d) Many entities' system and process configurations are tailored to how management analyzes the business, which does not align with the proposed disclosure requirements.

¹⁰ Respondents generally used the term "intercompany" in their comment letters; therefore, the terms "intercompany" and "intra-entity" are used interchangeably throughout this summary.

- (e) Many entities would not be able to isolate inventory and manufacturing expense from other required expense categories, especially for vertically integrated entities that experience difficulty in tracking the composition of inventory as it moves downstream in the value chain.
 - (f) Entities may incur significant costs and complexity isolating employee compensation from other workforce costs or determining and tracking employee cost allocations between functions.
 - (g) The proposed amendments do not address the effect of proportionate consolidation and joint venture arrangements that generally include cost-sharing mechanisms between the parties.
 - (h) The proposed disclosures could result in the disclosure of competitively sensitive information.
93. In addition, several preparers and trade groups from certain industries expressed operability and cost concerns that are unique to a particular industry:
- (a) *Aerospace and defense.* Several respondents stated that the proposed amendments present unique challenges to this industry because of the nature of products and services offered, contract periods of performance that span several years, and regulatory and compliance requirements for the industry. Those respondents also expressed concern about the ability to disaggregate indirect costs that are allocated across many different programs and contracts. Specifically, those respondents explained that allocating indirect costs is a complex part of managing government contracts because indirect costs are applied to “cost objectives,” which is a regulatory term that can include a contract with the U.S. government, a project, a task, or a contract line item.
 - (b) *Insurance.* One preparer-focused trade group and one preparer stated that the proposed amendments would impose significant costs on preparers in the insurance industry that have been affected by recent standard setting.

Suggestions from Comment Letter Respondents to Improve Operability

94. In addition to the suggestions discussed in Issue 3A, some preparers suggested alternative disaggregation approaches that would improve the operability of the proposed amendments, as follows:
- (a) *Require disclosure of some or all of the required expense categories in total instead of disclosing amounts for each relevant expense caption.* One of the several respondents that provided this suggestion also suggested providing qualitative

disclosure of the balance sheet and income statement line items in which employee compensation is recognized. Another respondent stated that this approach would reduce implementation costs and improve comparability due to differences in income statement presentation between entities.

- (b) *Require that some or all expense categories be disclosed on an “as incurred” basis, either in total or disaggregated by relevant expense caption.* One of the few respondents that provided this suggestion recommended this approach specifically for employee compensation because of the expected challenges in “tracing compensation that is allocated to balance sheet projects.” Another respondent expressed its belief that such a requirement could be implemented sooner than the proposed amendments without compromising the decision usefulness of information for investors. Another respondent stated that disclosing costs incurred for employee compensation would “provide more timely trend information, rather than waiting for such amounts to be reflected in the income statement expense lines, which may come at least partially in future periods.”
- (c) *Align expense disaggregation with segment reporting (that is, use a management approach).* While many respondents commented that alignment with segment reporting would provide decision-useful information (as further described in Issue 3A of this summary), one preparer suggested a segments-based disaggregation approach to improve the operability of the proposed amendments. Specifically, that respondent recommended that an entity (i) determine which natural expenses are regularly reviewed by the CODM and (ii) separately disclose any of those expenses that exceed a quantitative threshold.
- (d) *Disclose natural expense cost categories as a percentage of total costs on a consolidated basis.* One respondent stated that this approach could reduce implementation costs by providing trend information with less precision.
- (e) *Permit the disaggregation of cost of sales for products and services together.* One respondent explained that it would be difficult to separate product and service costs into natural expenses and disclosing natural expense information separately may not be meaningful for investors.
- (f) *Disclose allocated costs in total instead of by nature.* In response to concerns raised in paragraph 92(a) of this handout, one respondent suggested disclosing allocated costs in total and providing qualitative disclosure to describe the components of those costs.

95. Some respondents provided the following suggestions to improve the operability and understandability of the proposed amendments:

- (a) *Clarify that the subsequent measurement of other types of assets may be classified as either depreciation or intangible asset amortization.* One preparer and two practitioners recommended that internal-use software be added to paragraph 220-40-50-9 to clarify that the subsequent measurement of that asset can be disclosed as either depreciation or amortization.¹¹
- (b) *Specify when items are subject to further disaggregation.* Several respondents provided suggestions to clarify the implementation guidance in Section 220-40-55:¹²
 - (i) One trade group suggested that the concepts described in paragraph BC36 be added to the proposed amendments.¹³ Accordingly, that respondent suggested including examples of employee compensation costs that would not be included within the scope of the proposed amendments, such as compensation costs that are capitalized on the balance sheet as an incremental cost to obtain a contract with a customer in accordance with Subtopic 340-40, Other Assets and Deferred Costs—Contracts with Customers.
 - (ii) One preparer-focused trade group recommended that the proposed amendments further clarify that the subsequent measurement or derecognition of assets (for example, amortization of regulatory assets recognized in accordance with Subtopic 980-340, Regulated Operations—Other Assets and Deferred Costs) need not be further disaggregated into the required expense categories (for example, employee compensation).
 - (iii) Two practitioners suggested clarifying the proposed amendments to state that certain accrued expenses that include an estimate of future employee compensation (for example, warranty expenses within the scope of Topic 460, Guarantees) need not be further disaggregated into the required expense categories when those liabilities are subsequently measured.

¹¹ Paragraph 220-40-50-9 states that “Amortization of a finance lease right-of-use asset recognized in accordance with paragraphs 842-20-35-7 through 35-8 and amortization of leasehold improvements recognized in accordance with paragraphs 842-20-35-12 through 35-13 shall be included as part of either depreciation in paragraph 220-40-50-4(c) or 220-40-50-18(c) or intangible asset amortization in paragraph 220-40-50-4(d) or 220-40-50-18(d).”

¹² Paragraph 220-40-55-3 states, as one of two examples, that “an entity that capitalized employee compensation when self-constructing new property, plant, and equipment for internal use is not required to further disaggregate the resulting depreciation into the categories required by paragraph 220-40-50-4.”

¹³ Paragraph BC36 states that “Capitalization of a cost to an asset affects the natural classification of that cost; any expense that is subsequently recognized would have a different natural classification than the cost that was capitalized.”

- (iv) One preparer suggested that the proposed disclosures for employee compensation not apply to any financial statement line item that includes insurance claims expense.
 - (c) *Additional illustrative examples.* One preparer suggested that a final Update include illustrative examples on how entities should apply the guidance when an entity is affected by cost center allocations and allocation rates, intra-entity transactions, and other system- and process-related operability challenges.
96. One preparer and one preparer-focused trade group recommended that the Board engage in field testing to assess how best to narrow the scope and identify costs and consequences of the proposed amendments. Three respondents recommended that the Board engage with major ERP providers to understand the timeline those providers would need to develop workable solutions for entities to implement.

Issue 3C: Proposed Definitions and Links to Other Guidance

Background and Comment Letter Feedback

Inventory Expense

97. The proposed definition of the term *inventory expense* is “an expense resulting from the derecognition of inventory due to sale to customers, consumption in the production of goods or services for such sale, or remeasurement (for example, an impairment) in accordance with Section 330-10-35 or any other Subsequent Measurement Section within an Industry Topic in Topic 330 on inventory.”
98. The proposed Update includes the following question:
- Question 5:** For preparers and practitioners, is the proposed definition of inventory expense operable? Please explain why or why not. If not, what changes would you make?
99. The majority of the 30 comment letter respondents that provided feedback on this question stated that the proposed definition of *inventory expense* is operable. Some of those respondents explained that the proposed definition would:
- (a) Align with relevant existing inventory accounting guidance and current practice.
 - (b) Improve financial reporting by isolating inventory costs, which would be helpful for investors in the absence of a definition of cost of goods sold (COGS).
 - (c) Provide flexibility to address entity- and industry-specific factors.

100. Some respondents that supported the proposed amendments provided the following suggestions to further enhance operability:
- (a) *Inventory impairments.* One practitioner recommended that the Board clarify whether obsolescence charges would be disclosed as a component of “other” or in a different line item when further disaggregating inventory and manufacturing expense (which is addressed in Issue 4 of this summary). One state society stated that impairment charges should be disclosed separately.
 - (b) *Other expenses recognized in COGS.* One preparer recommended that the Board clarify whether inventory expense would include “items traditionally reflected as cost of goods sold,” such as in-bound and out-bound freight, vendor sell-in and sell-through credits, warehousing and handling costs, costs of returned goods, obsolescence charges, and lower of cost or net realizable value charges.
 - (c) *Application-related matters.* One trade group recommended that the Board clarify the application of the proposed definition for standard costing adjustments and variance deferrals, valuation adjustments, and other judgments. One preparer suggested clarifying how nonmanufacturing entities with inventory (for example, retailers and entities that use contract manufacturing organizations) should disclose inventory and manufacturing expense. That respondent suggested removing the term *manufacturing* so that the line item is not misleading.
101. Several respondents indicated that the proposed amendments would not be operable because the proposed definition:
- (a) *May affect comparability across entities.* One preparer stated that the proposed definition of *inventory and manufacturing expense* (which includes the term *inventory expense*) is “intended to permit entities to disaggregate... based on an entity’s view of what constitutes manufacturing-related expenses,” which would reduce comparability across entities. Accordingly, the respondent recommended that the definition of *inventory expense* be both linked to the derecognition of inventory and include costs that are capitalizable to inventory but are recognized as a period expense. The respondent suggested that the Board provide an “exhaustive list” of costs that are subject to capitalization.
 - (b) *Is unclear.* A few respondents expressed concern that certain aspects of the proposed definition are unclear:
 - (i) One practitioner, one trade group, and one academic expressed concern about the phrase “consumed in the production of goods or services” in the proposed definition. Specifically, two of those respondents stated that the

proposed definition does not clearly indicate whether such consumption is directly linked to the sale of goods or delivery of services to customers. The other respondent stated that it was unclear whether the phrase would include only period costs that are not subject to capitalization or if it would include all costs incurred that are subject to capitalization.

- (ii) One preparer recommended that further guidance or clarification be provided on the application of standard costing methodologies.
 - (iii) One student group expressed concern that the proposed definition would not be operable for service providers. Specifically, that respondent recommended removing the term *services* from the definition.¹⁴
- (c) *Would not provide investors with decision-useful information.* One of the two respondents that provided this feedback recommended allowing entities to define *inventory expense* so that it aligns with how management operates the business and to improve consistency. The other respondent stated that it would be more helpful to define cost of sales because “it is the single largest expense item for most retail and manufacturing entities.”

Employee and Employee Compensation

102. The proposed Update amends the definition of the term *employee* in Topic 718, Compensation—Stock Compensation, by incorporating minor conforming changes to consider forms of compensation other than stock compensation. The proposed definition of *employee compensation* includes common significant types of cash compensation (such as salaries and bonuses) and noncash compensation (such as share-based compensation). That definition is a minimum requirement that would permit, but not require, that an entity provide certain types of noncash compensation (such as subsidized goods or services) to classify those amounts as employee compensation.
103. Additionally, the proposed Update provides a practical expedient that would allow certain entities (for example, banks) to disclose salaries and benefits in accordance with SEC Regulation S-X Rule 9-04 instead of applying the proposed definition of *employee compensation*.

¹⁴ The proposed definition of *inventory expense* incorporates the existing Master Glossary definition of *inventory* which includes “items of tangible personal property...to be currently consumed in the production of goods or services to be available for sale.”

104. The proposed Update includes the following question:

Question 6: The proposed amendments would leverage the existing definition of employee in Topic 718, Compensation—Stock Compensation, and would add a definition of employee compensation. For preparers and practitioners, are the proposed definitions of employee and employee compensation operable, including for entities with international operations, and would the proposed amendments affect entities' current application of the definition of employee in Topic 718? Please explain. What changes, if any, would you make? For preparers, would the proposed practical expedient that would allow certain entities to disclose salaries and benefits in accordance with SEC Regulation S-X Rule 9-04 be less costly to apply than applying the proposed definition of employee compensation? For investors, would permitting the application of that proposed practical expedient affect the decision usefulness of the proposed disclosures? For all stakeholders, should the definition of employee compensation include additional costs or exclude any of the costs proposed? Please explain why or why not.

105. The feedback received from respondents is summarized in the following sections:

- (a) Proposed definition of *employee*
- (b) Proposed definition of *employee compensation*
- (c) Application of the practical expedient.

Proposed Definition of Employee

106. A majority of the 33 respondents that commented on the proposed definition of *employee* stated that it is operable. Many of those respondents explained that the proposed definition is operable because it leverages the existing definition of *employee* in Topic 718. Some of those respondents stated that the proposed definition would not affect an entity's application of the definition of *employee* in Topic 718, while the other respondents did not address the issue. The remaining respondents that commented on the proposed definition of *employee* either stated that it was not operable or expressed neutrality.

107. Respondents (including respondents that supported the proposed definition) stated that:

- (a) The proposed definition likely would exclude temporary workers and independent contractors, which could limit comparability and the decision usefulness of the information resulting from the proposed amendments.
- (b) Entities, especially those with international operations, may incur significant costs and experience complexity when determining who qualifies as an employee. Additionally, some of those respondents indicated that the proposed definition would require an ongoing assessment of whether individuals qualify as employees.

108. Respondents (including some who supported the proposed definition) provided the following suggestions:
- (a) *Allow entities to define employee.* One of the few respondents that provided this suggestion explained that redefining the existing definition of *employee* could create complexity when applying existing guidance that references employees, which may lead to “unintended consequences of defining a commonly used term.”
 - (b) *Add a definition for nonemployees or expand the definition of employee to include temporary workers or independent contractors.* One of the several respondents that provided this suggestion recommended that the proposed amendments include any individual that received a Form 1099 from an entity. Alternatively, that respondent recommended that entities apply a state law test for independent contractors to identify workers who may have been misclassified as independent contractors.
 - (c) *Consider the effect of potential human capital disclosures on the proposed definition of employee.* One preparer and one practitioner suggested aligning the definition of *employee* with any final rule that may be issued by the SEC on human capital disclosures.

Proposed Definition of Employee Compensation

109. Thirty-five respondents commented on the proposed definition of *employee compensation*. A majority of those respondents stated that the proposed definition is operable, while the other respondents either stated that it is not operable or expressed neutrality on the issue. Some of the respondents stated that the proposed definition of *employee compensation* is operable because it includes a specific list of different types of cash and noncash compensation.
110. Some respondents that supported the proposed definition of employee compensation stated that it:
- (a) *Affects comparability.* One student group stated that the proposed definition removes potentially conflicting interpretations and assumptions about an entity’s employee compensation. In contrast, one trade group noted that permitting entities to include other amounts in employee compensation may reduce the consistency and comparability of amounts disclosed as employee compensation.
 - (b) *Provides flexibility.* One respondent stated that it supported both the “floor” for the types of costs that are required to be included in the proposed definition and the flexibility that would allow entities to include other types of costs (for example, subsidized goods or services). Another respondent stated that without that flexibility,

it would be “significantly more difficult and require us to perform a more holistic review of what constitutes employee compensation for items that are not immediately clear.”

111. Respondents (including some who supported the proposed definition) provided the following suggestions:

- (a) *Include additional compensation costs in the proposed definition of employee compensation:*
 - (i) One preparer commented that payroll taxes constitute direct employee-related costs even though employees may not consider those costs to be part of their compensation or benefits. Additionally, that respondent noted that social security contributions are included in the definition of employee benefits in IAS 19, *Employee Benefits*. That respondent also suggested renaming the required expense category to *employee compensation and related taxes* to avoid confusion on the composition of that expense category.
 - (ii) One student group suggested including retention bonuses in the proposed definition because that information could offer investors insights into an entity’s efforts and associated costs to retain its talent.
 - (iii) One practitioner stated that gifts and expense allowances should be added to the proposed definition. Additionally, that respondent commented that employees of international entities may benefit from certain government programs and, therefore, the proposed definition should be expanded to also “address benefits to employees at a more conceptual level.”
- (b) *Exclude stock-based compensation from the proposed definition of employee compensation.* One preparer stated that stock-based compensation is often excluded from non-GAAP measures and, accordingly, investors may prefer that it be excluded from the proposed definition.
- (c) *Require disclosure of other forms of compensation included in or excluded from employee compensation.* One investor disagreed with the proposal that would allow entities to include other forms of compensation because it would diminish comparability. That respondent suggested either requiring that those forms of compensation be included in the proposed definition or removing the option. Similarly, one practitioner stated that the requirement to disclose a description of other forms of compensation included in employee compensation may disincentivize entities from including those amounts in their disclosures. Therefore, that respondent suggested requiring that those amounts be included in the disclosure or, if optionality

is retained, require disclosure of the description of those forms of compensation even if they are not included in the disclosure of employee compensation.

- (d) *Allow entities to determine how they define and disclose employee compensation and other labor-related expenses.* One preparer-focused trade group stated that providing flexibility would better align employee compensation with internal views.

Application of the Practical Expedient

- 112. Some comment letter respondents provided feedback on the practical expedient:
 - (a) Six respondents commented on the costs of applying the practical expedient and stated that it would be less costly than applying the proposed definition of *employee compensation*.
 - (b) Seven respondents commented on the utility of the practical expedient and stated that it would not affect the decision usefulness of the proposed disclosures.
- 113. One preparer-focused trade group that commented on both the costs and decision usefulness of applying the practical expedient stated that it demonstrates a balance of enhancing transparency for investors while limiting “unnecessary cost” for the banking industry.
- 114. One practitioner recommended that the practical expedient be extended to entities that disclose, rather than present, salaries and benefits information required by SEC Regulation S-X Rule 9-04. Another practitioner suggested extending the practical expedient to additional entities, such as those that present an expense caption for salaries and employee costs on the face of the income statement.

Depreciation and Amortization

- 115. The proposed Update includes the following question:

Question 7: For preparers and practitioners, would linking depreciation and intangible asset amortization to existing disclosure requirements in Subtopic 360-10, Property, Plant, and Equipment—Overall, and Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill, be operable? Please explain why or why not.

- 116. Nearly all of the 27 comment letter respondents that provided feedback on this question stated that linking depreciation and intangible asset amortization to existing disclosure requirements in Subtopic 360-10 and Subtopic 350-30 would be operable. Many of those respondents explained that:
 - (a) The proposed amendments would improve understandability and consistency.

- (b) The proposed amendments would require limited effort because (i) the current disclosure requirements in Subtopic 360-10 and Subtopic 350-30 are well understood in practice and (ii) entities have existing systems and processes to support compliance with those disclosure requirements.
- 117. Some respondents that supported the proposed amendments provided suggestions to further enhance operability. One preparer and one practitioner indicated that the proposed amendments would be redundant with current disclosure requirements in Subtopic 360-10 and Subtopic 350-30. One of those respondents recommended that the Board allow the proposed amendments to satisfy the disclosure requirements in Subtopic 360-10 and Subtopic 350-30 if the proposed disclosures address an entity's total depreciation expense and intangible asset amortization expense, respectively.
- 118. One trade group indicated that the proposed amendments would not be operable without further clarification. Specifically, that respondent explained that the proposed Update "requires a company to choose whether to present amortization of a finance lease right-of-use asset recognized in accordance with Subtopic 842-20, Leases—Lessee, as either depreciation or intangible asset amortization." Some of that respondent's members indicated that doing so would not be consistent with Subtopic 360-10 and Subtopic 350-30 and "means the amounts will not reconcile to other disclosed amounts for depreciation and intangible asset amortization in the financial statements."

Issue 4: Further Disaggregation of Inventory and Manufacturing Expense

Background

- 119. The amendments in the proposed Update would require the further disaggregation of inventory and manufacturing expense into the following categories of costs incurred:
 - (a) Purchases of inventory
 - (b) Employee compensation
 - (c) Depreciation
 - (d) Intangible asset amortization
 - (e) DD&A.
- 120. Those costs incurred would include both costs that are (a) capitalized as inventory on the balance sheet and (b) manufacturing costs that are expensed directly to the income statement when incurred. The proposed amendments would provide an entity with flexibility to classify certain expenses as part of its manufacturing activities and would require that an entity disclose how it defines other manufacturing expenses.

121. Additionally, because the proposed disaggregation of inventory and manufacturing expense is based on costs incurred, the following additional captions are required to be disclosed to reconcile costs incurred to inventory and manufacturing expense:
- (a) Other adjustments and reconciling items, which may include items related to foreign currency translation or the derecognition of inventory through other transactions, such as the sale of a business
 - (b) Changes in the inventory balance period over period.
122. The sub-issues that will be addressed in this issue are as follows:
- (a) Issue 4A: Decision Usefulness of Information Provided to Investors
 - (b) Issue 4B: Operability and Costs of the Proposed Amendments—Preparers
 - (c) Issue 4C: Potential Practical Expedients.

Issue 4A: Decision Usefulness of Information Provided to Investors

Background and Comment Letter Feedback

123. The proposed Update includes the following question:

Question 8: The proposed amendments would require further disaggregation of inventory and manufacturing expense into the following categories of costs incurred: (a) purchases of inventory, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) DD&A. Those costs incurred categories would include costs that flow into the balance sheet as inventory and also would include manufacturing costs that are expensed directly. The costs incurred categories would not represent costs flowing from inventory on the balance sheet to the income statement when that inventory is sold or impaired. Residual costs incurred would be included in an “other” category. For investors, would this proposed disclosure provide decision-useful information? If so, how would that information be used? If not, what changes would you make? Would any of the proposed costs incurred categories not provide decision-useful information? For example, are there categories that would be more decision useful than the ones being proposed? Should the proposed requirement to further disaggregate costs incurred that flow into the balance sheet as inventory be expanded to include assets other than inventory? If so, which assets?

Feedback on the Decision Usefulness of the Proposed Amendments

124. Two student groups and one academic stated that the proposed amendments would provide investors with decision-useful information. One student group stated that while the further disaggregation of inventory and manufacturing expense would provide investors with additional decision-useful information, the relevance of the disclosure would likely vary

across industries. For example, that respondent stated that the further disaggregation of inventory and manufacturing expense may not be relevant for entities in the services industry. In addition, one academic stated that an approach that disaggregated inventory and manufacturing expense that is recognized in the income statement in the current period into natural expense categories (for example, employee compensation) would be most beneficial for users of the financial statements. However, that respondent noted that the proposed cost incurred approach would be a cost-beneficial alternative that also would provide investors with decision-useful information. That respondent explained that the information would be decision useful because it includes better visibility into an entity's cost structures (for example, materials purchased, direct and indirect labor, and overhead affecting cost of sales) and the nature of those costs for modeling purposes (for example, understanding the recurring or nonrecurring nature of certain costs). That respondent also noted that the further disaggregation of inventory and manufacturing expense may assist investors in identifying potential earnings management by entities.

125. Several respondents, including a few investors and an investor-oriented trade group, asserted that the proposed disaggregation of inventory and manufacturing expense is not decision useful for investors. Two of those respondents stated that the cost incurred approach would be both complex and confusing for investors. An investor-oriented trade group stated that "without the investors reading the detailed provisions of this proposed Update, it is unlikely that investors will even be able to understand what this approach is meant to convey." One student group indicated that the information provided by the disaggregation of inventory and manufacturing expense may be decision useful for investors but had similar concerns around the complexity and potential confusion that may result from the cost incurred approach.
126. Although this aspect of Question 4 in the proposed Update was targeted toward investors, most preparer respondents across a wide range of industries, trade groups, and other respondents expressed concern about the decision usefulness of the information that would be provided by the further disaggregation of inventory and manufacturing expense. Those respondents provided the following reasons to explain why the expected benefits of the resulting information may not justify the operability challenges and costs to implement the proposed amendments:
- (a) Disaggregated information about inventory and manufacturing activities is not typically requested by an entity's investors and analysts.
 - (b) The disaggregation is not consistent with how management of an entity reviews the information and assesses its performance because the information does not adequately reflect the entity's operating results.

- (c) The proposed disaggregation for inventory and manufacturing expense will not provide investors with meaningful information about the nature of the underlying costs and/or will lack comparability across entities.
- (d) The cost incurred approach and reconciliation to inventory and manufacturing expense for the period is not intuitive and will cause confusion.
- (e) The cost incurred disaggregation may not provide meaningful information that can be used for forecasting an entity's operating results due to cyclicalities, seasonality, or lengthy production times.

Suggestions from Comment Letter Respondents to Improve Decision Usefulness

127. A few respondents suggested certain changes be made to the inventory and manufacturing expense disaggregation in order to provide investors with decision-useful information. Those suggestions included both broad changes to the disaggregation approach and more targeted changes to the cost categories included in the disaggregation disclosure, as follows:

- (a) One investor stated that the proposed amendments would not provide sufficient, additional insight into an entity's underlying cost drivers that significantly affect the entity's financial performance. Accordingly, the investor recommended that an entity be required to disclose additional information about labor costs, significant material prices, and energy and utility costs.
- (b) One investor-oriented trade group provided several recommended changes to the further disaggregation of inventory and manufacturing expense, as follows:
 - (i) The respondent recommended a requirement to further disaggregate the "changes in inventory" and the "other reconciling items and adjustments" captions that are required as part of the further disaggregation of inventory and manufacturing expense. The respondent stated that many entities may disclose large amounts for those items (for example, if any entity experiences a change in customer demand or supply chain issues) but, as currently proposed, those items would have "no decision-usefulness for investors because they result from several factors with different implications."
 - (ii) The respondent recommended that an inventory rollforward disclosure be required, in addition to the costs incurred disaggregation of inventory and manufacturing expense, which would help users reconcile inventory on the balance sheet, COGS on the income statement, and the required cost incurred disaggregation. The respondent stated that "not providing a rollforward of

inventory—including a tabular presentation that reconciles to the income statement—creates, for investors, unnecessary challenges to contextualizing and understanding the [further disaggregation of inventory and manufacturing expense]...which can be readily solved by preparers providing a rollforward of inventory.”

- (iii) The respondent also suggested that purchases of inventory be disaggregated into “purchases of raw materials” and “purchases of intermediate and finished goods.” The respondent noted that the term “purchases of inventory” is clear for retailers and distributors because they generally purchase finished goods, but the recommended terms would better fit a broad range of entities who may purchase more than finished products. This suggestion is consistent with feedback from another investor that observed that the “purchases of inventory” category would be helpful in evaluating retailers but may be far less relevant when evaluating other business models.
- (c) One student group suggested providing the disaggregation of a relevant expense caption and further disaggregation of inventory and manufacturing expense in a single table instead of the two-table format illustrated in paragraph 220-40-55-11. Similarly, one student group proposed combining the further disaggregation of inventory and manufacturing expense with the requirement to disaggregate relevant expense captions by required expense categories (that is, inventory and manufacturing expense would be replaced as a required expense category by the subcategories that comprise it, including purchases of inventory, other adjustments and reconciling items and changes in inventory). A second recommendation by that respondent is to remove the requirement to further disaggregate inventory and manufacturing expense. The respondent stated that the simplicity of not providing the disclosure may outweigh the loss of additional information for investors and that the disclosure of aggregate inventory and manufacturing expense would still represent an improvement over existing requirements.
- (d) Several respondents suggested certain updates or clarifications to the term *purchases of inventory* that is included in paragraph 220-40-50-18(a), as follows:
 - (i) To drive additional comparability, one preparer and one trade group representing preparers suggested that the Board develop a definition of *purchases of inventory*. One respondent suggested that the Board should incorporate the notion of certain costs that are capitalizable to inventory under Topic 330 into the definition. The respondent also suggested the following definition:

Costs incurred for goods and services obtained from external parties that are capitalizable to inventory under Topic 330. This excludes items that would be capitalizable to inventory under Topic 330, except that guidance in Topic 330 or other Topics prohibits such capitalization.

The respondent suggested that the Board provide an exhaustive list of exceptions to the definition, including items such as manufacturing overhead related to abnormally low production and certain interest costs. Another respondent stated that defined terms are “key to reliable financial reporting and analysis and of paramount importance to ensure consistent application and facilitate meaningful comparability between companies.”

- (ii) Three practitioners and one preparer suggested that the Board provide additional incremental guidance on the types of costs to be aggregated within the *purchases of inventory* cost category. One of those practitioners stated that it is “unclear whether items such as in-bound shipping or freight costs, effects of hedging derivatives, or rebates should be included in purchases of inventory.” This respondent noted that if the Board chooses not to define the term *purchases of inventory* or provide additional clarification, it could instead require preparers to define the cost category and qualitatively disclose their definition. Furthermore, another practitioner and one preparer recommended that the Board clarify whether purchases of inventory should be presented net of consideration received from a vendor.
- (iii) One academic observed that the Board should separate purchases of inventory from amounts that are recognized as part of an asset acquisition, business combination, or initial consolidation of a variable interest entity that is not a business. Currently, the proposed guidance in paragraph 220-40-50-18(a) requires that those amounts be included in the same cost category within the further disaggregation of inventory and manufacturing expense. However, the respondent noted that amounts recognized in an asset acquisition, business combination, or initial consolidation of a variable interest entity are “economically distinct from an entity’s ordinary purchases from its suppliers” and, therefore, should be separated to assist investors in their analyses of an entity’s operations. Similarly, one practitioner suggested separately presenting inventory acquired through a business combination because (1) it is measured at fair value and (2) including those amounts within the proposed *purchases of inventory* cost category may not accurately reflect purchasing trends.

- (e) One student group suggested that the further disaggregation of inventory and manufacturing expense may not provide investors or analysts of certain industries with decision-useful information. For example, the respondent noted that the disaggregation may not be relevant for entities in the services industry. Therefore, the respondent suggested that the proposed Update also include a further disaggregation of costs of providing services or provide guidelines for other industries in which the disaggregation of inventory and manufacturing expense may not be relevant. The respondent further noted that the industry guidelines should include additional industry-specific recurring expenses to be included within the disaggregation.
 - (f) One academic recommended adding a cost category of “manufacturing overhead not included above” to the further disaggregation of inventory and manufacturing expense required in paragraph 220-40-50-18. The respondent highlighted that overhead costs are an important component of COGS and cost of goods manufactured and, therefore, it would be helpful to separate those amounts from the “other” cost category in paragraph 220-40-50-18(f). In addition, that respondent suggested that it may benefit investors to require additional information about raw materials, work in progress, and finished goods to be included in the further desegregation of inventory and manufacturing expense because it may help investors better understand product costs. The respondent noted that preparers would likely have the beginning and ending balances for those inventory amounts.
 - (g) One investor stated that it would be helpful as part of his analysis to understand the degree to which executive compensation is included in the employee compensation component of inventory. The respondent noted that this amount could be provided as a percentage of the employee compensation costs included in the further disaggregation of inventory and manufacturing expense.
128. A few respondents suggested that the requirements to further disaggregate inventory and manufacturing expense should be expanded to other assets that are comprised of multiple types of natural costs, as follows:
- (a) *Extend the proposed requirement to amortization and intangible assets.* One investor stated that it would be helpful to understand the costs incurred for assets that are later amortized, such as internal use software. Similarly, another respondent suggested a requirement to further disaggregate amortization expense using costs incurred and capitalized to intangible assets because the disaggregation of COGS for entities without inventory (for example, service providers and entities that offer software cloud services or digital media) is limited. That respondent also highlighted

that further disaggregating amortization expense would provide investors with more visibility into other costs incurred and capitalized in the period and would help eliminate any asymmetry in the reporting requirements across different types of entities.

- (b) *Extend the proposed requirement to other assets.* One practitioner stated that it would encourage the Board to expand the proposed requirements to other assets that include capitalized employee compensation. Additionally, one student group noted that it may be beneficial to expand the proposed requirement to other costs that flow into the balance sheet, such as research and development or property, plant, and equipment.

Issue 4B: Operability and Costs of the Proposed Amendments—Preparers

Background and Comment Letter Feedback

Feedback on Operability and Costs of the Proposed Amendments

129. The proposed Update includes the following question:

Question 9: The proposed amendments would require (a) that the costs incurred that were capitalized to inventory during the current period be combined with other manufacturing expenses and (b) that this total of manufacturing-related expenses be disaggregated and disclosed separately from nonmanufacturing expenses. For preparers, would this proposed requirement be more or less costly to implement than if all such costs (manufacturing and nonmanufacturing) were permitted to be combined? For preparers and practitioners, is this proposed requirement operable? Please explain why or why not.

Feedback on Cost of Separating Manufacturing from Nonmanufacturing Expenses

130. Most comment letter respondents that provided feedback on this question generally agreed that it would be more costly to separately disclose manufacturing and nonmanufacturing expenses, as required by the proposed Update, than if those expenses were permitted to be combined. Those respondents generally indicated that separating those costs that are manufacturing from those that are nonmanufacturing within an entity's ERP systems would be a time-consuming and costly process.
131. Several respondents, including one preparer and two preparer-focused trade groups, questioned whether separating manufacturing and nonmanufacturing expenses would result in decision-useful information for investors. One respondent stated that it does not believe the separation would be helpful for investors because it would not provide additional insights into whether costs are fixed or variable in nature. This respondent also

observed that the separate disclosure of manufacturing and nonmanufacturing costs would not provide additional context on whether the costs were recurring or nonrecurring in nature. Another respondent noted that separating manufacturing from nonmanufacturing “seems to be an excessive breakout of cost of sales and will require costly and time-consuming changes in reporting systems for minimal value as nonmanufacturing costs are usually immaterial in nature.” The respondent further suggested that a more meaningful disclosure for investors would be a disaggregation of COGS into natural expense categories, as determined by the entity.

132. In contrast, one preparer stated that combining manufacturing and nonmanufacturing expenses would result in less decision-useful information for investors and, therefore, did not support an alternative of combining those expenses. However, the respondent acknowledged that the required separation would be more costly than the alternative.

Feedback on Operability

133. Some preparers and practitioners noted that the requirement to separate manufacturing expenses from nonmanufacturing expenses was operable.
134. In contrast, other respondents stated that the requirement to separately disclose manufacturing and nonmanufacturing expenses is not operable. One of those respondents noted that the requirement to separate manufacturing and nonmanufacturing expenses would create a new expense classification that is not currently tracked by entities. This respondent further questioned whether the separation was meaningful because manufacturers should not have significant nonmanufacturing costs recognized in the COGS expense caption. Another respondent stated that because of “disparate definitions that are likely to arise [in other manufacturing expense], we believe the resulting disaggregation of information will not be comparable between entities. Manufacturing and nonmanufacturing expenses within each relevant expense caption should be combined for purposes of disaggregating expenses within that caption.”
135. Although direct responses about the operability of separately disclosing manufacturing and nonmanufacturing expenses were limited, many preparers and other respondents provided comments more broadly on the operability and costs of further disaggregating inventory and manufacturing expense. Much of that feedback was consistent with concerns expressed by respondents about the operability of disaggregating relevant expense captions into required expense categories (as described in paragraphs 87–96 of this handout).

136. Many respondents explained that the requirement to further disaggregate inventory and manufacturing expense would require significant updates and redesign of their existing systems. Those respondents generally noted that preparers' systems are designed, or configured, to report functional costs when they are expensed in the period and are not currently able to provide information on natural costs categories when they are incurred. One respondent stated that "we do not believe the proposed disaggregation by line item (including the inventory roll-forward) is operationally feasible for [us] as our systems are not configured to track and collect costs by their nature, nor does management use this information by financial statement line to manage the business." Another respondent noted that tracking the composition of inventory as it moves through its system may not be possible without significant and costly modifications. Furthermore, one practitioner that supported the proposed cost incurred disaggregation acknowledged that many accounting systems do not currently provide the reporting that would be needed to comply with the requirement and, as a result, noted that "entities may resort to manual reconciliations, which result in increased costs for preparers as well as increased audit fees resulting from additional procedures necessary for practitioners to audit these manual reconciliations."
137. In addition to the general feedback noted above, many preparers and other respondents provided the following specific feedback related to operability and cost challenges:
- (a) Obtaining disaggregated information will be complex and costly for entities with many decentralized subledger and/or ERP systems.
 - (b) Cost center allocations and intra-entity transactions limit or restrict visibility into the natural classification of expenses.
 - (c) The required cost category of purchases of inventory will be challenging to identify and disclose, largely due to system configurations and the application of standard costing.
138. A few respondents provided additional comments on operability challenges of the further disaggregation of inventory and manufacturing expense, which were not as pervasive among respondents. Two respondents explained that some entities may engage third-party contract manufacturers or may work with co-manufacturers for their products, which would make it challenging to disaggregate the natural costs incurred in those arrangements for purposes of further disaggregating inventory and manufacturing expense. In addition, three preparers and two preparer-focused trade groups noted that foreign currency transactions would create complexity when determining amounts to be disclosed for each cost category, especially in cases in which source data is in a difference currency than the currency used for general ledger reporting.

139. A few respondents recommended that the proposed requirement to further disaggregate inventory and manufacturing expense be removed from a final Update because of the operability challenges described above and the limited usefulness for investors.

Feedback on Defining and Classifying Other Manufacturing Expenses

140. The proposed Update also includes the following question:

Question 10: For preparers and practitioners, is the proposed requirement to classify certain expenses as part of manufacturing activities and disclose how an entity defines other manufacturing expenses (other manufacturing expenses together with inventory expense constitute inventory and manufacturing expenses) operable? Please explain why or why not. If not, what changes would you make?

141. Most comment letter respondents that provided feedback on this question generally agreed that the proposed amendments that would require that an entity disclose its definition of other manufacturing expense is operable.
142. The majority of respondents stated that the proposed amendment that would require that an entity disclose how it defines other manufacturing expense is operable. Those respondents generally noted that an entity's determination of expenses that constitute other manufacturing expenses will require judgment but disclosing the basis for an entity's judgments will be consistent with other Topics that require the disclosure of an entity's judgments (for example, Topic 606, Revenue from Contracts with Customers).
143. A few preparers stated that the proposed requirement for an entity to define other manufacturing expenses is not operable. Additionally, those respondents noted that inventory and manufacturing expense amounts would not be comparable between entities because of the proposed requirement for each entity to define those expenses.
144. Although most respondents noted that the proposed amendment that would require that an entity define other manufacturing expenses is operable, those respondents offered several clarifying suggestions:
- (a) One respondent requested that the Board further clarify how an entity should account for a change in its definition of other manufacturing expenses in a period after the initial adoption of the proposed guidance and whether such a change would be within the scope of Topic 250, Accounting Changes and Error Corrections.
 - (b) One respondent suggested that the Board define other manufacturing expenses. Another respondent recommended that the description in paragraph 220-40-50-6 be expanded to include additional examples of other manufacturing expenses. For example, the respondent recommended specifying that other manufacturing

expenses include costs to manufacture a customized product or to construct a facility under a long-term contract for which revenue is recognized over time in accordance with Topic 606.

- (c) Two respondents recommended that the Board consider whether additional examples of other manufacturing expenses may be necessary because the broad description of other manufacturing expense in the proposed amendments could create diversity among entities. One of those respondents suggested clarifying whether other manufacturing expenses would apply only to manufacturing entities and not to other entities with inventory-related costs.
- (d) One respondent highlighted that many entities could have a significant balance included in the “change in inventories” line item and suggested a requirement to qualitatively disclose the nature of the changes in inventory, similar to the proposed requirement in paragraph 220-40-50-21. That respondent also suggested that the Board remove reference to “manufacturing expense” when referring to “inventory and manufacturing expense” and, instead, use a more generic description of the expense categories because the proposed requirement may apply to nonmanufacturing entities (for example, distributors).
- (e) One respondent noted that paragraph 220-40-55-11 should be clarified to address whether the transfer of inventory in the sale of either a legal entity or a line of business would be included in the line item “other adjustments and reconciling items.”

Issue 4C: Potential Practical Expedients

Background and Comment Letter Feedback

145. The proposed Update includes the following question:

Question 11: For preparers and practitioners, are there any potential practical expedients that would simplify or reduce the costs associated with disaggregating inventory and manufacturing expense but would not significantly diminish the decision usefulness of the information provided to investors? For any potential practical expedients suggested, please explain your reasoning.

146. Thirty-eight comment letter respondents recommended a practical expedient or an alternative to the further disaggregation of inventory and manufacturing expense, which respondents expect would reduce the cost of providing the disclosure but not significantly reduce the quality of information provided to investors. The following suggestions are the most common suggestions provided by respondents:

- (a) *Provide an option, or a requirement, to further disaggregate inventory and manufacturing expense on an expense incurred basis instead of a costs incurred basis.* Multiple respondents provided variations of this recommendation, as follows:
- (i) One preparer and one practitioner recommended that the Board provide an option for entities to disaggregate inventory and manufacturing expense based on the prescribed natural categories using an expense incurred approach. One of those respondents noted that this method of disaggregation would be more transparent and intuitive for investors and would be easier for many entities to provide than the proposed cost incurred disaggregation.
 - (ii) One preparer-focused trade group recommended disaggregating inventory and manufacturing expense by (1) costs previously capitalized and expensed in the period and (2) costs expensed as incurred in the period. The respondent noted that those amounts are more easily determinable than the proposed cost incurred disaggregation. The respondent also suggested that an entity be required to provide a qualitative description of an entity's policy for standard costing and for capitalizing or expensing those costs. Lastly, the respondent noted that the recommended approach would provide transparency into the composition of inventory based on an entity's absorption policies and would provide visibility into the nonabsorbed amounts, which it stated is "a significant incremental disclosure on the drivers of gross margin and trends in these drivers when comparing with prior periods."
 - (iii) One practitioner suggested an alternative to disaggregate inventory and manufacturing expense based on amounts expensed to the income statement. This practitioner stated that "some companies may prefer this alternative approach if, for example, 'purchases of inventory' is the only material component of inventory and manufacturing expense."
 - (iv) One preparer also recommended that the Board provide an option for entities to present the proposed disaggregation on an expense basis but noted that flexibility in how those amounts are disclosed or derived should be allowed. For example, the respondent noted that "permitting preparers to disclose amounts consistently based on standard costing rates that are currently being utilized by management to run the business would significantly reduce the cost and complexity of implementing the proposal rather than prescribing the need to derive amounts for disclosure that are not currently being utilized." Additionally, the respondent highlighted that entities applying IFRS Standards

are provided with a similar option to either present natural cost categories on an as-incurred or as-expensed basis.

- (v) One preparer suggested allowing entities to present expensed amounts for direct materials, direct labor, overhead, and other expenses as an alternative to the proposed disaggregation. This preparer highlighted that most manufacturing entities should have this information readily available.
 - (vi) Two preparers and one preparer-focused trade group also recommended that the Board allow an option to disaggregate COGS based on expenses incurred, but those respondents did not further clarify or recommend expense categories to be included in the disclosure.
 - (vii) One practitioner highlighted that some preparers already disaggregate inventory and manufacturing expense using a cost expensed approach (for example, certain transport entities may present fuel costs on the face of the income statement) and, therefore, suggested that those entities be exempt from the proposed requirement.
 - (viii) One preparer suggested that the Board eliminate the further disaggregation requirement of inventory and manufacturing expense and, instead, require the disclosure of natural expense categories at a consolidated entity level (that is, a total amount).
- (b) *Allow an entity that already presents inventory purchases (or a similar caption) on the income statement to not have to provide the further disaggregation of inventory and manufacturing expense.* One preparer and one preparer-focused trade group noted that certain entities in the oil and gas industry already provide purchases of inventory or a similar natural expense caption either on the face of the income statement, in the notes to financial statements, or in the supplemental disclosures for those entities. Those respondents noted that the vast majority of inventory and manufacturing costs in their industries relate to purchases of products and, therefore, entities in the industry would incur significant costs to disclose the other immaterial categories (for example, employee compensation).
- (c) *Allow an entity to derive the amount for purchases of inventory indirectly.* Three preparers and one preparer-focused trade group recommended that the Board provide an expedient for entities to calculate the amount of inventory purchases by deducting all other natural cost categories. One respondent stated that this expedient would provide substantial relief in the cost of implementing the proposed Update

because of the challenges that entities will face in determining their purchases of inventory for the period.

- (d) *Allow an entity that falls below a certain threshold based on size to not be required to further disaggregate inventory and manufacturing expense.* Several respondents suggested including certain thresholds in the proposed Update, either for all entities or entities of a certain size, under which an entity would not be required to further disaggregate inventory and manufacturing expense. One respondent suggested that the Board consider a threshold based on total revenues, total assets, or both, under which manufacturing entities would not be required to provide the disclosure. Another respondent suggested that the Board consider adding a 10 percent threshold whereby entities that have inventory and manufacturing expense that is less than 10 percent of their total expenses would not be required to provide the disaggregation disclosure. Furthermore, one respondent suggested an expedient for smaller entities (for example, nonaccelerated filers or emerging growth companies (EGCs)) by which an entity would be required to disclose a cost category included in paragraph 220-40-50-18 only if the category is greater than 10 percent of total inventory and manufacturing expense.
- (e) *Allow a qualitative description about the nature of an entity's inventory balance and the entity's costing methodologies.* Several respondents recommended an alternative whereby an entity would be required to disclose additional information about (1) the nature of its inventory balance and (2) the entity's costing methodologies. Specific recommendations by those respondents include:
 - (i) One preparer recommended a "qualitative disclosure requirement of the amount of manufacturing costs capitalized as part of inventory during the reporting period, which would include labor, depreciation, and other costs, rather than the roll-forward requirement."
 - (ii) One preparer suggested requiring a qualitative description of the components of total inventory and manufacturing expense and an explanation of the entity's standard costing and overhead policies, including the components that comprise the standard costing and overhead rates/pools.
 - (iii) Another respondent that is a preparer-focused trade group recommended a qualitative disclosure of inventory expense due to the "complex, costly and potentially confusing" quantitative disclosure that is currently required by the proposed Update. The respondent further stated that "incorporating qualitative information into inventory expense disclosures can help investors gain a

deeper understanding of the company's inventory management practices and risk factors.”

- (iv) Another respondent recommended an alternative for entities that apply standard costs whereby the “purchase and other inventoriable costs are quantified based on a percentage of the component makeup of the standard costs and a reasonable methodology to identify the natural cost components of variances.” The respondent noted that an entity could then reasonably estimate and disclose the disaggregated components of inventory on the balance sheet and expense within cost of sales. The respondent further suggested that the disclosure be supplemented by a qualitative description of indicators that management uses to assess the entity's performance, such as differences between standard and actual costs.
- (f) *Allow an entity to include a required cost category in “other” if the entity determines that it is impracticable to quantify and separately disclose that category.* One practitioner recommended a practical expedient whereby an entity could include a cost category, as prescribed in paragraph 220-40-50-18, within the “other” category if it is impracticable to quantify and separately disclose the category. The respondent stated that this expedient would be similar to an expedient included in the IASB's proposal¹⁵ and should be available only after an entity makes a good faith effort to quantify the category and subsequently concludes that it cannot cost effectively do so. Furthermore, this recommendation is similar to another respondent's recommendation to include an impracticability exemption from disaggregating relevant expense captions into required expense categories (as described in paragraph 61(a) of this handout).
- (g) *Include scoping guidance whereby only certain entities are required to further disaggregate inventory and manufacturing expense.* Four preparers requested scoping guidance that would exclude certain entities from further disaggregating inventory and manufacturing expense. Each of those respondents recommended that the disclosure should be required only for manufacturing entities because the disclosure would not provide a significant benefit to investors of many other types of entities (for example, resellers and retailers or technology services) and would result in significant additional costs for those entities. One of the respondents also

¹⁵ The IASB's proposal for its Primary Financial Statements project included an expedient for when an entity changes the presentation, disclosure, or classification of an item and it is impracticable to reclassify amounts in comparative periods. The proposal states “[IAS 1.41] If an entity changes the presentation, disclosure or classification of items in its financial statements, it shall reclassify comparative amounts unless reclassification is impracticable...[IAS 1.42] When it is impracticable to reclassify comparative amounts, an entity shall disclose: (a) the reason for not reclassifying the amounts; and (b) the nature of the adjustments that would have been made if the amounts had been reclassified.”

suggested a predominance principle whereby only entities with a predominant or core business in manufacturing be required to provide the disclosure. Another respondent that the Board tailor the disclosure to certain sectors and create industry guidance for the disclosure requirement, similar to the industry-specific guidance in Topic 932.

- (h) *If substantially all of an entity's inventory and manufacturing expense is the result of a single cost category (for example, purchases of inventory), either require a quantitative disclosure of that single cost category or a qualitative disclosure of the required cost categories.* Two practitioners and one preparer-focused trade group suggested a practical expedient that would allow an entity to disclose only a single cost category, either quantitatively or qualitatively, if that category represents “substantially all” of the entity’s inventory and manufacturing expense. One of those respondents stated that this expedient could alleviate the costs of providing the other cost categories for entities that have limited manufacturing activities.
 - (i) *Require a separate inventory rollforward to provide additional context to investors about the relationship between income statement expenses and costs capitalized to the balance sheet.* One preparer, one state society, and one investor-oriented trade group recommended an inventory rollforward requirement. Two of those respondents suggested that the rollforward be added in addition to the further disaggregation of inventory and manufacturing expense. Those respondents highlighted that providing the disclosures would help investors contextualize how disaggregation connects to the income statement and balance sheet. However, one respondent noted that an inventory rollforward that is disaggregated by cost category (for example, purchases and employee compensation) should be required instead of the disclosure on the further disaggregation of inventory and manufacturing expense because the respondent stated that disclosure is inoperable.
147. A few respondents provided the following suggestions for practical expedients or other alternatives for the further disaggregation of inventory and manufacturing expense, which were not as pervasive among respondents:
- (a) One practitioner recommended providing entities that also report under IFRS Standards with an option to provide the disclosures required in the IASB’s proposal instead of the disclosures that would be required by the proposed Update. That respondent noted that this would further help to increase comparability with international entities.

- (b) One practitioner suggested allowing entities “with complex inventory costing systems and methods that include allocations and cost pools” to determine what constitutes purchases of inventory and to disclose that definition.
 - (c) One preparer suggested that instead of the disaggregation of inventory and manufacturing expense, an entity be required to qualitatively and quantitatively disclose further information about the nature of its inventory. The respondent provided an example of its own inventory that it discloses in the notes to financial statements which included several subcategories of its finished goods and raw materials. The respondent stated that “since inventory assets are stated at the lower of cost or net realizable value, they are a better representation of potential future cash flows and could provide decision-useful information to users.”
 - (d) One respondent recommended that an exemption be provided for the disaggregation of inventory and manufacturing expense if the majority of an entity’s goods are not capitalized into inventory. For entities operating in the industrial gas industry, the respondent stated that “inventory is generally limited as most of our product offerings are produced at or near the point of use due to the complexity and inefficiency of storing molecules at low temperatures.” Therefore, the respondent did not expect that the proposed disaggregation of inventory and manufacturing expense would provide investors with meaningful information.
148. Comment letter respondents also included the following additional requests for clarification related to the disaggregation of inventory and manufacturing expense:
- (a) One respondent requested clarification about whether inventory and manufacturing expenses should include the gain or loss on a derivative that is designated as a fair value hedge of inventory.
 - (b) One respondent stated that if a final Update includes the further disaggregation of inventory and manufacturing expense, the Board should clarify acceptable methods of completing the inventory reconciliation. Additionally, the respondent noted that the Board should explicitly acknowledge that the amounts included in the “other adjustments and reconciling items” could be significant, or vary over time, and should engage with auditors to understand how they would test the reconciliation methodology.
 - (c) One respondent requested guidance on how to classify variances within the disclosure requirements. The respondent also asked that the Board clarify how costs directly expensed to contracts that recognize revenue over time should be presented.

Issue 5: Integration of Existing Disclosure Requirements

Background

149. The amendments in the proposed Update would require that an entity include certain existing disclosures in the same tabular format disclosure as the disaggregation of relevant expense captions. Specifically, an entity would include existing disclosures of certain expenses, gains, and losses, as follows:
- (a) For which there is an existing requirement to disclose the amount and the caption(s) in the income statement to which the amount is recorded (paragraph 220-40-50-12)
 - (b) That are not subject to an existing requirement to disclose the income statement caption(s) to which the amount is recorded, but where the amount is recognized entirely in one relevant expense caption (paragraph 220-40-50-13).
150. The proposed Update includes the following questions on the integration of existing disclosure requirements:

Question 12: The proposed amendments would require that an entity include certain existing disclosures of expenses in the same tabular format disclosure as the disclosures that would be required by the proposed amendments. For investors, would including those expenses in the same tabular format disclosure provide decision-useful information? Would this improve your ability to locate relevant expense information in the notes to financial statements? Please explain why or why not. For preparers and practitioners, is this proposed requirement operable? Please explain why or why not. For all stakeholders, are there other existing disclosures that are not reflected in the proposed amendments and should be included in the lists in paragraph 220-40-50-12, paragraph 220-40-50-13, or both? Please explain why or why not.

Question 13: In addition to the disclosure requirements being proposed, should other expenses that are currently disclosed in the financial statements also be required to be integrated into the tabular format disclosures (for example, other expenses that an entity voluntarily discloses in total in the notes to financial statements)? Please explain why or why not.

Comment Letter Feedback

151. The feedback received from comment letter respondents is summarized in three categories:
- (a) Decision usefulness of the integrated disclosure requirements
 - (b) Operability of the integrated disclosure requirements
 - (c) Additional disclosures (including those that an entity voluntarily discloses).

Decision Usefulness of the Integrated Disclosure Requirements

152. One investor-oriented trade group, one academic, and one student group provided feedback on Questions 12 and 13 in the proposed Update. Those respondents noted that including certain existing disclosures in the same tabular format as the other disclosures required by the proposed Update would provide investors with decision-useful information. One of those respondents explained that including existing disclosures would “standardize the format” of the expense disclosures and make them easier for investors to access, analyze, and compare. Similarly, another respondent stated that including the existing disclosures “would improve investors’ ability to locate relevant expense information in the notes to financial statements and contextualize them within the expense captions presented on the income statement.” In addition, one respondent cited academic research suggesting that consistent disclosures are useful to investors because they reduce investors’ information processing costs, which is generally associated with lower information asymmetry.
153. Although this portion of Question 12 was directed toward investors, several other respondents provided comments and noted that including existing disclosures within the proposed Update would not provide investors with decision-useful information:
- (a) Several respondents observed that the proposed requirement would make it easier for investors to locate relevant information; however, most of those respondents expressed concern that the disclosed amounts may lack context without other quantitative and qualitative information from the existing footnote disclosures.
 - (b) Several respondents highlighted that including the existing disclosures in the tabular format disclosure may increase the complexity of the disclosure and noted that the potential duplication of existing disclosures may confuse investors.
 - (c) One respondent explained that investors’ inability to locate information in the financial statements has decreased over the past decade as a result of XBRL tagging. Furthermore, the respondent also highlighted that investors use software that can extract information throughout the financial statements for use in their analyses and, therefore, consolidation of this information in a single disclosure may not be as useful.

Operability of the Integrated Disclosure Requirements

154. Nearly all respondents that provided feedback on this issue agreed that including the existing disclosure requirements in the tabular format disclosure would be operable. In general, respondents noted that the information would be readily available for inclusion in

the tabular disclosure. Furthermore, one respondent noted that the requirement would be a “practical and cost-effective way” of reducing the amount of other items.

155. Notwithstanding the general agreement on the operability of the proposed requirement, several respondents provided suggestions to improve the proposed amendments, as follows:

- (a) One respondent explained that it may be challenging to maintain completeness of the two prescribed lists included in the proposed Update over time and also questioned whether the proposed amendments would provide investors with decision-useful information. Therefore, the respondent provided three recommendations:
 - (i) An alternative that would provide entities with an option to cross-reference to other relevant footnotes in conjunction with the requirement in paragraph 220-40-50-16 to provide a qualitative description of other remaining items, which would provide investors with relevant information and simplify the disclosure requirement.
 - (ii) If the existing proposed requirements are retained, the respondent recommended a principles-based approach that would explain the intent of the proposed guidance without providing detailed lists of the existing disclosures. Instead, the respondent recommended providing several illustrative examples using items that are currently included in paragraphs 220-40-50-12 through 50-13.
 - (iii) If the existing proposed requirements are retained, and the principles-based approach above is not allowed, then the respondent suggested that the following items be included in paragraphs 220-40-50-12 through 50-13: (1) the amount of acquisition costs amortized for the period in paragraph 944-30-50-1(c), (2) the total amount charged to advertising expense for each income statement presented in paragraph 720-35-50-1(b), and (3) components of net benefit cost recognized (other than service cost amounts included within employee compensation) in paragraph 715-20-50-1(h).
- (b) Additionally, two respondents suggested removing the condition in paragraph 220-40-50-13 for including existing disclosures listed in that paragraph in the tabular format disclosure only if they are included entirely in one relevant expense caption (that is, those respondents suggested that the disclosures should be included in the table regardless of the number of captions the expenses are included in). One practitioner highlighted that the proposed requirement to include the existing

disclosure requirements listed in paragraph 220-40-50-13 only if those items are included in one relevant expense caption could allow an entity to avoid disclosure if those items are reported in multiple captions, which could result in (i) a lack of comparability between entities, (ii) structuring opportunities if an entity wants to avoid disclosure, and (iii) quantitatively large "other" categories. Therefore, this respondent suggested aligning the disclosure requirements regardless of whether entities include the amounts in multiple expense captions.

- (c) One practitioner recommended adding paragraph 832-10-50-3(c), which requires that an entity disclose the line items on the income statement that are affected by transactions with a government entity within the scope of Topic 832, Government Assistance, and the amounts applicable to each financial statement line item, to the proposed disclosures in paragraph 220-40-50-12. The respondent also suggested that paragraph 220-40-50-13(h) be removed from the proposed requirement because paragraph 350-40-50-3, inclusive of its reference to Subtopic 360-10, does not require separate disclosure of amortization of capitalized implementation costs. The respondent noted that if the Board believes that amortization of capitalized implementation costs is required to be separately disclosed, the respondent suggested specifying that it would be a specific additional disclosure.
- (d) One preparer provided several recommendations for the disclosures required by paragraphs 220-40-50-12 through 50-13 in the proposed Update:
 - (i) The respondent recommended that the proposed requirements be optional for entities because the information is not decision useful for investors and results in added complexity of the disclosure. However, if the proposed Update is issued as currently drafted, then the respondent stated that all expenses included in paragraphs 220-40-50-12 through 50-13 should be required to be disclosed, regardless of whether those amounts are presented in a single expense caption or multiple expense captions.
 - (ii) The respondent recommended clarifying whether employee compensation may be further disaggregated in the tabular format disclosure, when components of that amount are disclosed elsewhere in the footnotes pursuant to other Topics (for example, Topic 718). The respondent also recommended similar clarification for components of intangible asset amortization that may be disclosed separately in the footnotes (for example, those amounts in Subtopic 350-30).

- (e) Two practitioners and one trade group suggested additional clarification for comparability issues that may arise (for example, when an amount included in paragraph 220-40-50-13 is included in a single relevant expense caption in one year after having been presented in multiple relevant expense captions in the comparative year). Two respondents suggested providing illustrative guidance to address comparative disclosures. The other respondent suggested that the guidance be updated to state that “an entity must disaggregate an expense in one year but would not have to disclose it in a comparable period because, although the entity incurred the expense in the comparable period, such expense is not exclusively included in a single relevant expense category in that period and thus comparable disaggregation would not be required.” In addition, the respondent suggested that the guidance clarify that the disclosure of an amount in paragraph 220-40-50-13 would not be required if an entity allocates an immaterial amount of the expense to one relevant expense caption and allocates the majority of such expenses to another relevant expense caption.
- (f) One preparer and one preparer-focused trade group recommended removing the requirement to integrate existing expense disclosures. One of those respondents stated that preparers should be allowed to apply professional judgment on whether any expense categories should be separately disclosed.

Additional Disclosures (Including Voluntary Disclosures)

- 156. Most comment letter respondents did not support requiring the integration of other disclosures into the tabular format disclosure (for example, other voluntary disclosures). Generally, respondents stated that the disclosure requirements should not be overly prescriptive. Furthermore, the respondents noted that if those amounts were required to be included in the disclosure, it would not provide investors with incremental, decision-useful information and entities would incur additional time and costs aggregating the information.
- 157. Respondents provided the following comments:
 - (a) One preparer explained that the integration of voluntarily disclosures into the tabular disclosure would “distract from the goal of providing decision-useful information about material expenses.”
 - (b) One preparer explained that a requirement to disclose additional expenses in the tabular disclosure would result in duplicative information within the footnotes, which potentially could result in investors missing the material issues because less meaningful information would be disclosed.

- (c) Two practitioners and two preparers stated that although the disclosures should not be required, entities should be permitted to include expenses that are currently disclosed elsewhere in the financial statements. One respondent recommended clarifying in the proposed Update that the tabular format disclosures may include those other disclosures and that including those disclosures does not require disaggregation beyond the otherwise existing requirements.
 - (d) One preparer stated that each entity should be allowed to include voluntarily disclosed information in the tabular disclosure if it determines that circumstances warrant including the information. However, for other required disclosures (that is, disclosures that are required elsewhere in the footnotes), the respondent explained that including those disclosures in the tabular format disclosure could be beneficial if it (i) reduces duplication elsewhere in the financial statements or (ii) is specifically referenced to other notes to the financial statements where the full context resides.
158. A few respondents supported requiring additional expenses to be disclosed within the tabular format disclosure. One of those respondents explained that this requirement would “further accomplish the Board’s goal of enhancing readability for the users of the financial statements without significant additional costs for preparers.” Another respondent noted that it would support integrating disclosures of stock-based compensation, effects of foreign currency, and any other required or voluntary disclosures related to income statement expense captions into the tabular disaggregation disclosure.

Issue 6: Qualitative Description of Other Items

Background

159. The amendments in the proposed Update would require that an entity provide a qualitative description of any other items remaining in relevant expense captions and any costs remaining in inventory and manufacturing expense (also referred to as the “residual”). The proposed amendments would not expressly prohibit entities from providing additional disaggregation that is not required by the proposed Update.
160. The proposed Update includes the following question:

Question 14: The proposed amendments would require that an entity provide a qualitative description of any other items remaining in relevant expense captions and any costs remaining in inventory and manufacturing expense after the specific disaggregation requirements are applied. For investors, would this proposed requirement provide decision-useful information? If so, how would that information be used? If not, what changes would you make? For preparers and practitioners, is this proposed requirement operable? Please explain why or why not.

Comment Letter Feedback

161. The feedback received from comment letter respondents is summarized in two categories: decision usefulness and operability of the proposed amendments.

Decision Usefulness

162. Feedback from the 18 comment letter respondents that addressed the decision usefulness of the proposed amendments was mixed.
163. Some respondents stated that the proposed amendments would provide investors with decision-useful information. One academic stated that investors use qualitative disclosures in their decision-making processes and management employs those disclosures as a “credible signaling mechanism” about future performance. One student group explained that investors may use the qualitative descriptions of other items to (a) understand how entities across industries categorize their expenses and (b) analyze whether those expenses are managed effectively.
164. The majority of respondents stated that the proposed amendments would provide investors with little to no decision-useful information. Some of those respondents provided the following reasons:
- (a) The residual may be quantitatively significant.
 - (b) The residual may be material in the aggregate but made up of items that are individually insignificant.
 - (c) Qualitative descriptions of other items would not be useful for evaluation or valuation purposes without corresponding quantitative information.
 - (d) The disclosures may limit comparability between entities and between periods for the same entity.
 - (e) The disclosures may cause confusion.
165. Five of the respondents that did not support the proposed amendments suggested applying a materiality threshold to further disaggregate the residual. For example, one student group suggested that an entity be required to further disaggregate a residual that is at least 10 percent of the aggregate expense caption amount, while another student group suggested a 20 percent threshold. One investor-oriented trade group recommended that additional disaggregation be required if the residual exceeds 5 percent of each disaggregated relevant expense caption. That respondent provided the following suggestions for an entity to meet the 5 percent “ceiling:”

- (a) Increase the amount of required expense categories (as further discussed in Issue 3A of this summary)
- (b) Require the disclosures in paragraph 220-40-50-13 even if the amounts are included in multiple income statement expense captions (as further discussed in Issue 5 of this summary)
- (c) Encourage management to exercise discretion for defining and disaggregating additional expense and cost categories beyond those required in the proposed Update.

Operability

166. Almost all of the 25 comment letter respondents that provided feedback on this issue agreed that the proposed amendments are operable. Some of those respondents explained that:
- (a) The proposed amendments are a practical and cost-effective way of providing information to investors.
 - (b) The information resulting from the proposed amendments already exists within most accounting systems.
167. One preparer-focused trade group and one practitioner stated that the proposed amendments are not operable. One of those respondents recommended omitting the qualitative description of other items and proposed “similar disclosure requirements of SEC Regulation S-X Rule 5-02.”¹⁶ The other respondent recommended eliminating the requirement to provide qualitative descriptions of other items for the following reasons:
- (a) The consistency and comparability of the disclosures between entities would be limited.
 - (b) The proposed amendments lack clarity regarding the quantitative considerations that an entity should consider when providing the qualitative disclosure.
 - (c) The data needed to implement the qualitative disclosure may not be readily available and, therefore, the proposed amendments would require the development of new processes to collect and verify the data.

¹⁶ This recommendation was interpreted to be a requirement to separately disclose any other items that exceed 5 percent of the total relevant expense caption or the total costs in inventory and manufacturing expense.

Issue 7: Selling Expenses

Background

168. The amendments in the proposed Update would require that an entity disclose total selling expenses and, on an annual basis, how it defines selling expenses.
169. The proposed Update includes the following question related to selling expenses:

Question 15: The proposed amendments would require that an entity disclose selling expenses and how it defines selling expenses. Should a definition of selling expenses be developed, or should an entity be required to determine what constitutes a selling expense? For investors, would the proposed requirement provide decision-useful information? If so, how would that information be used? If not, what changes would you make? For preparers and practitioners, is the proposed requirement operable? Please explain why or why not.

Comment Letter Feedback

170. The feedback received from comment letter respondents is summarized in four categories:
- (a) Definition of selling expenses
 - (b) Decision usefulness of selling expense information
 - (c) Other operability matters
 - (d) Suggestions from comment letter respondents.

Definition of Selling Expenses

171. Forty-five respondents commented on whether the Board should develop a standardized definition of selling expenses or if entities should be required to determine what constitutes a selling expense. Although several respondents provided suggestions to improve the operability or decision usefulness of the proposed requirement, most respondents supported requiring that entities determine what constitutes a selling expense. Some respondents either did not support the proposed requirement for an entity to determine what constitutes a selling expense or preferred a standardized definition of selling expenses.
172. Many respondents that supported requiring entities to determine what constitutes a selling expense (rather than creating a standardized definition) explained that:
- (a) Differences in how industries and entities view selling expenses would create challenges in creating a standardized definition.

- (b) The resulting information would be more relevant than a prescribed definition because it would provide investors with information about how an entity manages its operations.
 - (c) An entity-specific definition would enhance the operability of the proposed amendments.
 - (d) Information about selling expenses is readily available to entities.
173. Most of the respondents that supported developing a standardized definition of selling expenses expressed concerns about comparability. For example, one practitioner and one trade group explained that the lack of a standardized definition of selling expenses, a detailed framework of what constitutes a selling expense, or specific examples of what entities would include in selling expenses would inherently reduce the usefulness and comparability of the proposed amendments. Similarly, one investor-oriented trade group stated that requiring entities to determine what constitutes a selling expense could result in an “unacceptably wide range” of definitions that impairs comparability across entities and even for the same entity over time. Additionally, one academic cited an academic study that suggests that the variability of items included in SG&A is due to the lack of clear definitions and, therefore, stated that the lack of a standardized definition for selling expenses will create noncomparability across entities and inconsistency of reporting over time.
174. A few of the respondents that preferred a standardized definition of selling expenses stated that the proposed amendments would still provide decision-useful information. However, those respondents explained that developing a standardized definition of selling expenses, or a standardized definition of selling expenses with industry-specific modifications, would enhance the decision usefulness of the proposed amendments.

Decision Usefulness of Selling Expense Information

175. Forty-five respondents commented on whether the proposed amendments for disclosing total selling expenses would provide decision-useful information. Some of those respondents supported the proposed amendments, while the majority of respondents were concerned about the decision usefulness of the information that would be provided.
176. Respondents that stated that the proposed amendments would provide decision-useful information explained that the proposed requirement would:
- (a) Provide meaningful insight into an entity's selling and marketing activities.
 - (b) Increase comparability of selling activities between entities.

177. Many preparer respondents and preparer-focused trade groups were concerned about the decision usefulness of the information that would be provided by the proposed amendments. Those respondents provided the following reasons to explain why the expected benefits of the proposed amendments may not justify the associated operability challenges and implementation costs:
- (a) The proposed amendments may lack relevance because (i) selling expenses on their own are not considered a key performance measure that is used to evaluate performance or manage entities in certain industries and (ii) investors typically only look at SG&A expense in total or as a percentage of revenue.
 - (b) The proposed amendments may limit comparability between entities within the same industry.
 - (c) Investors would not understand how to reconcile total selling expenses across various income statement line items if selling expenses are presented in multiple expense captions.
 - (d) The proposed disclosure may provide an incomplete picture of an entity's cost drivers because the definition of selling expenses is limited to a consolidated level and does not capture differences between its various segments.
 - (e) The proposed amendments may be either duplicative with, or contradictory to, existing guidance on direct selling expenses and deferred acquisition costs for entities in the insurance industry.

Other Operability Matters

178. Nearly all of the 28 respondents that commented on this issue stated that the proposed amendments are operable. Most of those respondents explained that the proposed requirement to disclose total selling expenses is operable because of the proposed requirement for an entity to determine what constitutes a selling expense. Accordingly, two of those respondents also explained that the proposed amendments would require minimal effort to implement.
179. One preparer-focused trade group stated that the proposed amendments are not operable because many retailers would not be able to separate selling expenses from other expense categories without changing financial reporting systems and processes.

Suggestions from Comment Letter Respondents

180. A few respondents provided the following recommendations to improve the decision usefulness and/or the operability of the proposed amendments:

- (a) *Further disaggregate selling expense into certain types of expenses.* One student group suggested that an entity be required to further disaggregate selling expense into the following types of expenses that align with the respondent's suggested definition of selling expense: advertising, marketing, customer acquisition, client relationship management, business development, market research, employee compensation, and other. Another student group suggested that selling expense be disaggregated into distribution, marketing, and selling expenses.
- (b) *Provide additional examples and implementation guidance.* Several respondents suggested that the proposed amendments include additional guidance in the form of either a framework, principles, examples, or a combination of those items to help determine what constitutes a selling expense. One preparer stated that such incremental guidance should clarify whether it is appropriate to include expenses presented in expense captions other than SG&A (or a similar caption) when disclosing total selling expenses. Similarly, two preparers, one practitioner, and one student group suggested providing examples of costs that could be included in or excluded from the disclosure of total selling expenses.
- (c) *Clarify certain aspects of the proposed amendment.* One practitioner suggested clarifying whether selling expenses is intended to be a subset of the amount that commercial and industrial entities present in SG&A on the face of the income statement in accordance with SEC Regulation S-X Article 5.

Issue 8: Interim Reporting

- 181. The amendments in the proposed Update would require that an entity provide the required disclosures, except for the definition of selling expenses and other manufacturing expenses, on both an interim and annual basis.
- 182. The proposed Update includes the following question on the reporting frequency of the proposed amendments:

Question 16: The proposed amendments would require the disclosures on both an annual basis and an interim basis. Do you agree with those proposed amendments? Please explain why or why not.

Comment Letter Feedback

- 183. Feedback on the proposed interim reporting requirement was mixed. While some of the 45 respondents that addressed this issue did not support the proposed interim reporting requirement, the majority of respondents either supported the proposed interim reporting

requirement or expressed neutrality on the issue and provided general comments or suggestions.

184. The feedback is summarized in three categories:
- (a) Decision usefulness of interim reporting
 - (b) Operability
 - (c) Suggestions from comment letter respondents.

Decision Usefulness of Interim Reporting

185. Several respondents stated that the proposed interim reporting requirement would provide investors with decision-useful information. One of those respondents strongly supported the proposed requirement and stated that interim reporting is “vital for confirmatory and predictive value.” Another respondent cited two academic studies that suggest that disaggregation provides investors with relevant information for quarterly and annual periods and that the benefits of disaggregation diminish over longer time horizons.
186. One preparer-focused trade group supported requiring the proposed disclosures at interim periods because investors asserted that this information is useful for modeling future earnings.
187. Many preparers, preparer-focused trade groups, and other respondents expressed concern about the decision usefulness of the information being provided at interim periods. Those respondents explained the following about why the expected benefits of receiving the information at interim periods may not justify the costs of providing the information at interim periods:
- (a) *Differences in presentation requirements for interim and annual periods.* Several respondents noted that the presentation requirements for interim periods are different than those required for annual periods. Three of those respondents commented that this could either affect comparability or cause confusion among investors. One respondent suggested including illustrative examples to clarify how to apply the proposed amendments when an entity’s interim financial statements are prepared in a condensed format with different income statement line items than those presented in the entity’s annual financial statements.
 - (b) *Sufficiency and predictive value of annual disclosures and other disclosure requirements.* A few respondents stated that the required expense categories subject to disaggregation either do not vary significantly on a quarterly basis or that annual disclosure would be sufficient to assess trends. Additionally, one of those respondents stated that interim disclosure requirements under other existing GAAP

are sufficient to address when a significant event or transaction occurred since the prior year-end.

188. Additionally, two preparer-focused trade groups and one preparer provided the following feedback related to the decision usefulness of providing the proposed disclosures on an interim basis that was not as pervasive among respondents:
- (a) One respondent stated that the components of expense captions presented on the income statement are not comparable quarter to quarter because of shifting external sales demand, internal manufacturing and distribution capacity changes, raw material availability, and supply chain lead times.
 - (b) Two respondents stated that, because of seasonality and other factors, requiring the proposed disclosure at interim reporting periods could result in misinterpretation by investors, result in a lack of context, cause issues for comparability, provide limited perspective on financial performance, and place undue emphasis on short-term results.

Operability

189. A few respondents stated that the proposed amendments are operable. Other respondents stated that they expect that interim reporting would be operable once the requisite system and/or process enhancements are made to comply with annual reporting of the proposed amendments. Some of those respondents explained that they expect ongoing costs to comply with the proposed requirements would not be significant.
190. Respondents also provided the following commentary about interim reporting:
- (a) Several respondents expressed concern about time constraints and/or resource requirements for interim reporting.
 - (b) Some preparers stated that it would be challenging for entities to apply the proposed amendments for acquired businesses in a timely manner.
 - (c) Some preparers stated that applying the proposed amendments on an interim basis would be costly.

Suggestions from Comment Letter Respondents

191. Many respondents provided suggestions on the proposed interim reporting requirement:
- (a) *Establish a materiality-based requirement.* Several respondents expressed that the proposed amendments should be required on an interim basis only when there is a material change from the previous annual disclosures. One preparer-focused trade group suggested that the proposed amendments apply to depreciation and intangible

asset amortization only when there is a material change in those items at interim reporting periods.

- (b) *Remove or modify the proposed requirement to further disaggregate inventory and manufacturing expense.* One preparer suggested requiring the further disaggregation of inventory and manufacturing expense only on an annual basis.

Issue 9: Transition and Effective Date

Transition Method

192. The amendments in the proposed Update would require that the proposed disclosures be applied on a prospective basis with an option for retrospective application. The proposed Update includes the following questions on transition:

Question 17: The proposed amendments would be applied on a prospective basis with an option for an entity to apply the guidance retrospectively. Is that proposed transition method operable? If not, why not and what transition method would be more appropriate and why? Would the information disclosed under the proposed transition method be decision useful? Please explain why or why not.

Question 18: For preparers, would you expect to apply the proposed amendments retrospectively, even if not required, to assist investors in comparing performance to previous periods? Please explain why or why not.

Comment Letter Feedback

193. Nearly all of the 51 respondents that commented on the overall operability of the proposed transition method stated that it is operable.
194. Thirty-four respondents commented specifically on the operability and/or decision usefulness of the option to apply the proposed amendments retrospectively. Almost all of those respondents supported the option to apply the proposed amendments retrospectively, while a few of those respondents recommended that retrospective application be required. Those respondents provided the following feedback about retrospective application:
- (a) Some respondents that supported an option (and not a requirement) to apply the proposed amendments retrospectively noted that there would be significant implementation costs and extensive system changes that would lead to a significant amount of time for preparers to implement the proposed amendments retrospectively.

- (b) A few respondents stated that requiring retrospective application would provide investors with the most decision-useful information because it would improve comparability and the ability to perform trend analyses upon adoption of the proposed amendments.
195. Twenty-one respondents (made up of preparers and preparer-focused trade groups) commented on whether they would expect to apply the proposed amendments retrospectively. Almost all of those respondents stated that they (or the entities they represent) would likely not apply the proposed amendments retrospectively because of the significant system and process challenges that are expected. For example, one of those respondents stated that applying the amendments prospectively would already require significant cost and effort and further explained that the expected system changes would “prohibit the ability to disclose the information retrospectively.”
196. In contrast, a few of those respondents indicated that they would expect to apply the proposed amendments retrospectively because the decision usefulness of the proposed disclosures would be limited without comparative prior-period information. For example, one respondent stated that it would be compelled to provide comparative prior-period information because only providing the disclosure prospectively could “result in misunderstanding or misuse of such information” when investors are unable to compare the information to prior periods.

Effective Date and Early Adoption

197. The Board did not include an effective date in the proposed Update because it is seeking stakeholder feedback to inform its decision.
198. Accordingly, the proposed Update includes the following question about the time needed to implement the proposed amendments and whether early adoption should be permitted:

Question 19: Regarding the effective date, how much time would be needed to implement the proposed amendments? Should early adoption be permitted? Please explain why or why not.

Comment Letter Feedback

199. Respondents generally indicated the need for a significant implementation period before the amendments in a final Update would be effective because of (a) significant changes to entities’ systems, processes, and controls that would be needed to comply with the proposed amendments and (b) resource constraints. Accordingly, some respondents provided the following recommendations for an effective date for some or all of the proposed amendments:

- (a) A minimum of 36 months.
 - (b) A minimum of 24 to 36 months.
 - (c) A minimum of 12 to 24 months.
 - (d) Defer interim reporting requirements by 12 months after the effective date for annual reporting requirements.
 - (e) Defer the further disaggregation of inventory and manufacturing expense by at least 12 months after the effective date for all other proposed requirements.
 - (f) Defer the effective date for certain types of entities, such as SRCs, EGCs, and entities that meet the definition of public business entities but previously did not (for example, significant equity method investees or joint ventures of public business entities).
 - (g) Provide a one-year period for adoption during which preferability of accounting policy changes (for example, expense reclassifications) would not need to be assessed.
 - (h) Consider the effective dates for other forthcoming and recently issued Updates.
200. Twenty respondents commented on and supported permitting early adoption of the proposed amendments, if finalized.

Other Feedback

201. Twenty-one respondents provided other feedback that is included in paragraphs 202–208 of this handout.

Segment Reporting

202. Several respondents noted that the expense categories in the proposed amendments are likely to be different than those presented when applying the guidance in Accounting Standards Update No. 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures*. Those respondents suggested that entities be required to reconcile disaggregated income statements expenses with significant segment expenses or that entities be required to disaggregate reportable segment expenses in accordance with the proposed amendments.
203. One respondent suggested that entities be required to apply the proposed amendments to segment expenses, in lieu of the management approach.

Human Capital Disclosures

204. A few respondents suggested that the proposed Update require the disclosure of additional human capital information (for example, total costs of human capital, head count, turnover rates, workforce diversity, and workforce composition).

Other Feedback

205. One practitioner noted that the proposed Update is “an expedient response to [investor] feedback by focusing on a finite number of common expense categories. However, with the continued proliferation of alternative performance measures and non-GAAP reporting outside of the financial statements...the FASB should do more to enhance the relevance and decision-usefulness of the primary financial statements for investors.” Therefore, that respondent recommended that the Board consider a longer term project on broader improvements to income statement presentation as part of or in addition to the existing research project focused on financial key performance indicators.
206. One preparer recommended that the Board perform additional research on the costs and benefits of the proposed amendments and consider any post-implementation review of the IASB’s primary financial statements project before finalizing the proposed amendments.
207. One investor focused trade group suggested that the Board perform additional outreach with software providers on system capabilities and conduct a post-implementation review of Accounting Standards Update No. 2016-14, *Not-For-Profit Entities (Topic 958): Presentation of Financial Statements for Not-For-Profit Entities*, to better understand the costs and operability of the proposed amendments.
208. One practitioner suggested that the Board clarify whether a change from one acceptable income statement presentation to another is a change in accounting principle or a reclassification if the Codification does not provide specific alternatives (for example, shipping and handling expenses). That respondent expressed that entities may change their income statement presentations when implementing the proposed amendments and observed that Topic 250 does not provide specific guidance for those circumstances.

Board Meeting Handout
Accounting for Environmental Credit Programs
January 31, 2024

Meeting Purpose

1. The purpose of the January 31, 2024 Board meeting is for the Board to continue its initial deliberations on the Accounting for the Environmental Credit Programs (ECP) project, including recognition and measurement for environmental credit obligations (ECOs), presentation, and two sweep issues related to scope and asset requirements.

Questions for the Board

Issue A: Recognition

1. Does the Board want to require that an entity recognize a liability when activities or events occurring on or before a balance sheet date indicate that an ECO exists?
2. Does the Board want to specify that an entity should consider the balance sheet date as the end of the compliance period when determining whether to recognize an ECO liability, regardless of whether the compliance period ends at a future date?
3. For obligations requiring that an entity remit a fixed number of environmental credits to a regulator solely as a result of existing as a business as of an assessment date, does the Board want to provide separate recognition requirements?
4. If yes to Question 3, which alternative does the Board prefer?

Alternative 1: An entity would be required to recognize a liability for the fixed number of credits that it has been assessed on the date that it becomes obligated. The entity would recognize an asset at the same time, measured on the same basis as the liability. The asset would then be amortized over the compliance period and the liability derecognized when environmental credits are remitted to the regulator.

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

Alternative 2: An entity would recognize a liability ratably over the compliance period for the fixed number of credits assessed. The liability would be derecognized when environmental credits are remitted to the regulator.

Issue B: Initial Measurement

Consideration of the Funded and Unfunded Portions of an ECO Liability

5. Does the Board want to require initial measurement requirements for an ECO liability that separately consider the funded portion and the unfunded portion of an ECO liability as of the balance sheet date?

Measurement of the Funded Portion of an ECO Liability

6. Does the Board want to require that an entity measure the funded portion of an ECO liability at the carrying amount of environmental credits using the entity's best estimate of the compliance environmental credits to be derecognized upon settlement, consistent with any portfolio or costing methods applied by the entity for purposes of applying the asset measurement guidance?
7. If yes to Question 6, does the Board want to require that an entity apply the funded liability measurement guidance after applying the asset recognition, measurement, and reassessment requirements?

Measurement of the Unfunded Portion of an ECO Liability

8. Which of the following alternatives does the Board prefer for measurement of the unfunded portion of an ECO liability?

Alternative 1: An entity would measure the unfunded portion of an ECO liability using the fair value at the balance sheet date (determined in accordance with Topic 820, Fair Value Measurement) of the environmental credits necessary to settle the liability at that date.

Alternative 2: An entity would measure the unfunded portion of an ECO liability using the fair value at the balance sheet date (determined in accordance with Topic 820) of the environmental credits necessary to settle the liability at that date, unless either of the following:

- (a) If the entity intends to settle the ECO liability by remitting cash to the regulator, using the cash settlement amount prescribed by the compliance program

- (b) If the entity intends to settle the ECO liability using environmental credits obtained through a commitment to purchase a fixed quantity of environmental credits at a fixed price (existing at the balance sheet date), using the estimated cost basis of those credits to be obtained through that contract.

Alternative 3: An entity would measure the unfunded portion of an ECO liability using its best estimate of the carrying amount of consideration (cost of environmental credits or cash) to be used to settle that liability. An entity's best estimate would consider the estimated cost basis of compliance environmental credits to be obtained in future periods and used to settle that liability, regardless of whether it has rights to those credits at the balance sheet date.

Issue C: Subsequent Measurement

9. Does the Board want to require that an entity apply the initial measurement guidance at each balance sheet date and recognize any changes in the measurement of an ECO liability through earnings, presented in the same income statement line item as the initial measurement of the ECO liability?

Issue D: Derecognition

10. Does the Board want to require that an entity derecognize ECO liabilities in accordance with Topic 405-20, Liabilities—Extinguishment of Liabilities, with gains and losses recognized upon derecognition presented in the same income statement line item as the initial measurement of the ECO liability?

Issue E: Interim Requirements

11. For interim reporting, does the Board want to require that an entity apply the same recognition and measurement guidance decided for Issues A and B above?

Issue F: Balance Sheet Presentation

12. Which of the following alternatives does the Board prefer for the balance sheet presentation of environmental credits?

Alternative 1 (Gross): An entity would be required to present all compliance environmental credit assets and ECO liabilities separately on the balance sheet. That is, an entity would be prohibited from offsetting its ECO liabilities and the associated compliance environmental credit assets.

Alternative 2 (Net): An entity would be required to offset an ECO liability with the associated compliance environmental credit assets.

Alternative 3 (Gross with Net Option): An entity would be permitted to elect an accounting policy to offset an ECO liability with the associated compliance environmental credits, which would be applied consistently to all ECO liabilities.

Issue G: Balance Sheet Classification

13. Does the Board want to require that an ECO liability reasonably expected to be settled within one year from the balance sheet date be classified as a current liability and require all other ECO liabilities be classified as noncurrent liabilities?
14. Does the Board want to require that an environmental credit reasonably expected to be sold, traded, or remitted to a regulator to satisfy an ECO liability within one year from the balance sheet date (or the operating cycle of the business, if longer) be classified as a current asset and require that all other environmental credits be classified as noncurrent assets?

Issue H: Statement of Cash Flows

15. Does the Board want to require that cash flows associated with ECPs be presented in accordance with Topic 230 and clarify within the ECP guidance that the following be classified within operating activities?
 - (a) Payments for environmental credits to be used to settle ECO liabilities
 - (b) Payments for environmental credits to be sold in contracts with customers within the scope of Topic 606, Revenue from Contracts with Customers (including those carried in a trading account in accordance with paragraph 230-10-45-18)
 - (c) Payments for environmental credits not recognized as assets, such as those acquired for voluntary reporting purposes or internal emissions or pollution reduction targets
 - (d) Receipts from sales of environmental credits in contracts with customers within the scope of Topic 606 (including those carried in a trading account in accordance with paragraph 230-10-45-18).

Issue I: Sweep Issues—Scope*Derivatives*

16. Does the Board want to clarify in the ECP guidance that recognized environmental credits and environmental credit obligation liabilities would not be evaluated under Topic 815, Derivatives?

Fair Value Option

17. Does the Board want to specify that an entity would not be permitted to elect the fair value option in Topic 825, Financial Instruments, for measuring an ECO liability?

Issue J: Sweep Issues—Asset Requirements

18. Does the Board want to specify that an entity would not be permitted to capitalize the cost of environmental credits that will not be sold or used to settle an ECO liability as part of another asset?
19. Does the Board want to clarify that nonrefundable deposits for environmental credits that will not be sold or used to settle an ECO liability would be required to be recognized as an expense upon payment?

Stakeholder's Feedback and Current Practice

2. The staff conducted outreach with many of the Board advisory groups and multiple stakeholders, including several preparers, large practitioners, and preparer industry groups (hereinafter referred to as "outreach stakeholders"). Outreach stakeholder feedback indicates that ECOs are currently immaterial for most entities. However, consistent with representations about voluntary uses of environmental credits, outreach stakeholders expect that the prevalence of ECOs will increase with the increased focus on emissions reductions and expansion of regulatory programs.
3. The staff's research and outreach indicates that most regulatory programs obligate an entity to remit environmental credits to a regulator or its designee when the entity emits (timing of settlement is often on a cumulative basis after a stipulated compliance period). Therefore, the staff learned that entities typically recognize a liability as they emit. Most entities measure the liability at the balance sheet date, starting with the carrying amount of compliance environmental credits owned at that date (hereinafter referred to as the "funded portion of an ECO liability"). To the extent that an entity has insufficient compliance environmental credits at the balance sheet date (hereinafter referred to as the "unfunded

portion of an ECO liability”), diversity exists in measuring the unfunded portion of an ECO liability. Some entities measure the unfunded portion of an ECO liability as the price to purchase the quantity of environmental credits necessary to settle that obligation at the balance sheet date (that is, the current market price of the unfunded quantity of environmental credits). Other entities measure the unfunded portion of an ECO using a “best estimate” of expected future cash outflows necessary to settle the unfunded portion of an ECO liability, which may be different from simply using the market price of an environmental credit multiplied by the unfunded quantity.

4. Certain entities consider purchase commitments to receive environmental credits in the future. For example, utility companies often enter into long-term bundled purchase arrangements for renewable energy and renewable energy certificates (RECs), referred to as power purchase agreements (PPAs). Entities also obtain RECs through virtual PPAs.
5. While the provisions of compliance programs vary, the staff’s outreach and research indicates that most programs fall into one of the following categories:
 - (a) *Type A compliance programs (Type A)*: This group represents almost all compliance programs. Under those programs, each qualifying activity results in an incremental environmental credit obligation for an entity. In those programs, once a qualifying action occurs (for example, delivery of electricity to customers), the entity is required to remit an environmental credit to the regulator at the compliance program’s settlement date. There is no action that the entity can perform to reduce the number of credits required to be remitted.
 - (b) *Type B compliance programs (Type B)*: Although far less common than Type A compliance programs, some compliance programs calculate an entity’s ECO based on qualifying activities over a period of time. Therefore, unlike Type A compliance programs, an entity’s future actions can reverse the need to remit credits.
 - (c) *Type C compliance programs (Type C)*: Under a Type C program, an entity is generally permitted to produce or emit up to a certain amount before any credits are owed. These are commonly referred to as baseline programs. After meeting the established threshold (that is, the baseline), each qualifying activity results in an incremental obligation for the entity (the same as a Type A program).
 - (d) *Type D compliance programs (Type D)*: In a Type D program, an entity is required to remit a fixed number of environmental credits solely as a result of existing as a business as of an assessment date. As a result, the entity becomes obligated at a point in time rather than over time.

Issue A: Recognition Model

6. For Type A, Type B, and Type C compliance programs, the staff developed a recognition model for the Board's consideration that would require that an entity recognize a liability when activities or events occurring on or before a balance sheet date indicate that an ECO exists. Under that model, an entity must assume that the balance sheet date is the end of the compliance period to determine whether a present obligation exists, regardless of whether a compliance period is aligned with that date or ends at a future date.
7. For Type D programs, the staff is proposing the following two alternative recognition models for the Board's consideration:
 - (a) *Alternative 1:* An entity would recognize a liability for the total number of credits it has been assessed on the date that it becomes obligated. The entity would recognize a deferred cost asset for the same amount on that date. The asset would be amortized over the compliance period.
 - (b) *Alternative 2:* An entity would recognize a liability for the total number of credits it has been assessed ratably over the assessment period.

Issue B: Initial Measurement

8. In situations in which an entity is holding compliance environmental credits, stakeholders broadly supported measuring the funded portion of an ECO liability based on the carrying amount of compliance environmental credits owned by an entity (a linked model). Those stakeholders stated that the cost of credits surrendered to satisfy an obligation represents the cost of settling that obligation. One practitioner stakeholder offered a different view. That stakeholder suggested that an entity be required to use the average cost of *all* environmental credits that could be used to settle the ECO liability, even if the entity did not intend to use those environmental credits for that purpose. That stakeholder preferred that approach because it would require less judgment and would minimize the ability for the entity to manage earnings through changes in which environmental credits are used for liability measurement.
9. When an entity holds compliance environmental credits in excess of what is necessary to settle an existing ECO liability, an entity will need to choose which compliance environmental credits (or which portfolio of compliance environmental credits) that it intends to use to settle the obligation. That decision will determine the measurement of the ECO liability at the balance sheet date. If the entity ultimately settles the ECO liability with different environmental credits than it previously used to measure that liability, a gain or loss upon

settlement (and derecognition) may occur when the carrying amount of the asset derecognized does not equal the carrying amount of the liability derecognized.

10. Outreach stakeholders also provided feedback for measuring the unfunded portion of an ECO liability. Most outreach stakeholders suggested that those ECO liabilities be measured using the fair value of environmental credits necessary to settle that obligation (that is, the amount that would be paid to purchase the necessary credits at the balance sheet date), with limited exceptions. Those stakeholders stated that an entity's future actions should not affect the measurement of a present obligation and that the measurement of the ECO liability should reflect the cost that an entity would incur if it were to settle the obligation as of the balance sheet date.
11. A few preparer stakeholders offered a different view. Those stakeholders recommended that an entity be permitted to forecast the expected cost of obtaining the environmental credits necessary to satisfy the ECO liability. Those stakeholders stated that an ECO liability should represent the expected cash outflows that will be incurred to settle the liability rather than the value of the obligation as of the balance sheet date. For example, if an entity expects to increase solar energy production next quarter and in turn would be granted environmental credits before the settlement of the ECO liability, the obligation would be measured at zero because there are no incremental cash outflows directly associated with obtaining those granted credits or settling the liability.
12. Outreach stakeholders also indicated that entities may consider other factors when measuring the unfunded portion of an ECO liability, including:
 - (a) The cash settlement amount of the ECO liability (often, programs contain a penalty to be paid in lieu of remitting credits)
 - (b) The expected carrying amount of environmental credits to be received before settlement of an ECO liability through purchase commitments (forward contracts) executed on or before the balance sheet date.
13. The staff has developed the following initial measurement alternatives for the Board's consideration:
 - (a) *Alternative 1:* An entity would measure the unfunded portion of an ECO liability using the fair value at the balance sheet date (determined in accordance with Topic 820) of the environmental credits necessary to settle the liability at that date.
 - (b) *Alternative 2:* An entity would measure the unfunded portion of an ECO liability using the fair value at the balance sheet date (determined in accordance with Topic 820) of the environmental credits necessary to settle the liability at that date, unless either of the following occurs:

- (i) If the entity intends to settle the ECO liability by remitting cash to the regulator, using the cash settlement amount prescribed by the compliance program
- (ii) If the entity intends to settle the ECO liability using environmental credits obtained through an unconditional purchase obligation existing at the balance sheet date, using the estimated cost basis of those credits to be obtained through that contract.
- (c) *Alternative 3:* An entity would measure the unfunded portion of an ECO liability using its best estimate of the carrying amount of consideration (cost of environmental credits or cash) to be used to settle that liability. An entity's best estimate would consider the estimated cost basis of compliance environmental credits to be obtained in future periods and used to settle that liability, regardless of whether it has rights to those credits at the balance sheet date.

Issue C: Subsequent Measurement

- 14. Stakeholders' feedback indicates that specific subsequent measurement guidance requirements are necessary to mitigate any ambiguity or potential for diversity in practice. Stakeholders supported a requirement to apply the initial measurement guidance at each balance sheet date. Additionally, all outreach participants recommended that changes in measurement be recognized through earnings.

Issue D: Derecognition

- 15. Subtopic 405-20 applies to all financial and nonfinancial liabilities unless guidance in another Topic specifically addresses derecognition for that liability. That Subtopic provides the following applicable derecognition guidance:

405-20-40-1: Unless addressed by other guidance..., a debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:

- a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes the following:
 - 1. Delivery of cash
 - 2. Delivery of other financial assets
 - 3. Delivery of goods or services
 - 4. Reacquisition by the debtor of its outstanding debt securities whether the securities are cancelled or held as so-called treasury bonds.
- b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. For purposes of applying Subtopic 405-20, a sale and related assumption effectively accomplish a legal release if nonrecourse debt (such as certain mortgage loans) is assumed by a third party in

conjunction with the sale of an asset that serves as sole collateral for that debt.

16. Outreach stakeholders generally supported a requirement to derecognize an ECO liability in accordance with Subtopic 405-20. Those stakeholders indicated that in almost all circumstances it is readily apparent when an ECO liability is extinguished and should be derecognized. Those stakeholders observed that the rules and regulations of almost all compliance programs clearly specify settlement procedures and the criteria for settlement and, furthermore, the conditions necessary to satisfy those procedures are objective and verifiable.
17. For example, in most compliance programs an entity is required to remit an environmental credit directly to a regulator as the form of settlement. Similarly, in some compliance programs, an entity is required to surrender, retire, or otherwise abandon legal ownership of an environmental credit. In those instances, the liability is generally considered extinguished at the point in time that conforming environmental credits are retired, surrendered, or otherwise abandoned.
18. One stakeholder observed that Subtopic 405-20 requires that an entity determine if the entity has been “relieved” or “released” from its obligation. That stakeholder further observed that such a determination is inherently based on an entity’s legal obligations may require that an entity obtain regulator confirmation or other legal documentation in certain cases.

Issue E: Interim Requirements

19. Most GAAP is applied consistently for annual and interim periods; however, some Topics have different recognition and measurement requirements for interim reporting. Paragraphs 270-10-45-1 through 45-2 state that:

270-10-45-1 Interim financial information is essential to provide investors and others with timely information as to the progress of the entity. The usefulness of such information rests on the relationship that it has to the annual results of operations. Accordingly, each interim period should be viewed primarily as an integral part of an annual period.

270-10-45-2 In general, the results for each interim period shall be based on the accounting principles and practices used by an entity in the preparation of its latest annual financial statements unless a change in an accounting practice or policy has been adopted in the current year (see paragraphs 270-10-45-12 through 45-16). However, certain accounting principles and practices followed for annual reporting purposes may require modification at interim reporting dates so that the reported results for the interim period may better relate to the results of operations for the annual period.

Issue F: Balance Sheet Presentation

20. Outreach stakeholders indicated diversity in practice exists in presentation of ECPs, particularly when an entity owns environmental credits that it intends to use to settle ECO liabilities. Because of that diversity, stakeholders recommended that the Board provide balance sheet presentation requirements, specifying whether an entity is required to present compliance environmental credits and ECO liabilities separately or if an entity is permitted to present a net ECO liability.
21. Based on stakeholders' feedback and existing GAAP, the staff has identified the following alternatives for the Board's consideration:
 - (a) *Alternative 1 (Gross)*: An entity would be required to present all compliance environmental credits and ECO liabilities separately on the balance sheet. That is, an entity would be prohibited from offsetting its ECO liabilities and the associated compliance environmental credit assets.
 - (b) *Alternative 2 (Net)*: An entity would be required to offset an ECO liability with the associated compliance environmental credits.
 - (c) *Alternative 3 (Gross with Net Option)*: An entity would be permitted to elect an accounting policy to offset an ECO liability with the associated compliance environmental credits, which would be applied consistently to all ECO liabilities.

Issue G: Balance Sheet Classification

22. Entities that present a classified balance sheet are required to classify assets and liabilities as current and noncurrent. Topic 210, Balance Sheet, defines *current assets* as cash and other assets that are reasonably expected to be realized in cash or sold or consumed during the operating cycle of the business. An operating cycle is defined as the longer of one year or the average time intervening between the acquisition of materials or services and the final cash realization. Topic 210 defines *current liabilities*, in part, as obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets.

Issue H: Statement of Cash Flows

23. Topic 230, Statement of Cash Flows, provides guidance for classifying cash receipts and payments as operating activities, investing activities, or financing activities. The following cash flows are commonly associated with ECPs:
 - (a) Purchases of compliance environmental credits (those to be used to settle environmental credit obligations)

- (b) Purchases of environmental credits for resale to customers (including for trading purposes)
 - (c) Purchases of environmental credits for voluntary purposes (such as environmental, social, and governance reporting and other internal emissions or pollution reduction targets)
 - (d) Sales of environmental credits to customers (including trading activities).
24. The following cash flows associated with ECPs are less common:
- (a) Cash settlement of environmental credit obligations (for example, paying a fine instead of remitting environmental credits)
 - (b) Purchases of environmental credits as an investment
 - (c) Sales of environmental credits held as an investment.

Issue I: Sweep Issues—Scope

Topic 815—Derivatives

25. During outreach, one practitioner stated that a requirement to transfer environmental credits to the government at a future date may be a host contract containing an embedded derivative related to the forward delivery of environmental credits when (a) those credits are readily convertible to cash or (b) an entity is permitted to cash settle its obligation based on the value of the credits at the settlement date.

Fair Value Option

26. During outreach, one stakeholder indicated that entities may be permitted to elect the fair value option in Topic 825, Financial Instruments, to account for an ECO liability. That stakeholder reasoned that an ECO liability may meet the Master Glossary definition of a *financial liability* when an entity is permitted to settle the ECO liability in cash (regardless of how punitive the cash settlement amount is). Furthermore, the stakeholder observed that fair value determined in accordance with Topic 820 considers credit risk and may result in a smaller liability measurement than the price of the environmental credits necessary to settle the obligation.

Issue J: Sweep Issues—Asset Requirements

27. At its October 11, 2023 meeting, the Board decided that an entity would recognize an asset for an environmental credit when it is probable that the credit will be used to settle an ECO or separately transferred in an exchange transaction (for example, sold or traded). The Board also decided that costs incurred to obtain all other environmental credits would be

recognized as an expense when incurred *unless the costs are included in the carrying amount of another asset in accordance with other GAAP.*

28. Following the October Board meeting, stakeholders provided additional feedback on how the Board's tentative decision may be applied in practice, including feedback that the cost of voluntary credits may often be included in the carrying amount of another asset (inventory, prepaids, and so forth).