FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: July 31, 2023
Comments Due: October 30, 2023

Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40)

Disaggregation of Income Statement Expenses

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 220 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2023-ED500, FASB, 801 Main Avenue, PO Box 5116 Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until October 30, 2023. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2023-ED500
- Sending a letter to "Technical Director, File Reference No. 2023-ED500, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

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Disaggregation of Income Statement Expenses

July 31, 2023

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Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

Feedback from investors, lenders, creditors, and other allocators of capital (collectively, “investors”) on the 2021 FASB Invitation to Comment, *Agenda Consultation,* indicated that disclosure of disaggregated financial reporting information (in the income statement, the statement of cash flows, or the notes to financial statements) should be a top priority for the Board. Investors have observed that more detailed information about expenses is critically important in understanding an entity's performance, assessing an entity's prospects for future cash flows, and comparing an entity’s performance both over time and with that of other entities. Investors specifically indicated that more granular information about cost of sales and selling, general, and administrative expenses (SG&A) would assist them in better understanding an entity’s cost structure and forecasting future cash flows. Some investors also noted that employee compensation costs should be disclosed in greater detail.

The Board is issuing this proposed Update to improve the disclosures about a public business entity’s expenses and address requests from investors for more detailed information about the types of expenses (including employee compensation, depreciation, and amortization) in commonly presented expense captions (such as cost of sales, SG&A, and research and development).

The Board expects that nearly all public business entities, particularly those that present expense captions, such as cost of sales and SG&A on the face of their income statements, would disclose more information under the amendments in this proposed Update about the components of those expense captions than is disclosed in financial statements today. That incremental information should allow investors to better understand the components of an entity’s expenses, make their own judgments about the entity’s performance, and more accurately forecast expenses, which in turn should enable investors to better assess an entity’s prospects for future cash flows. It also should provide contextual information for an entity’s preparation and an investor’s consideration of management’s discussion and analysis of financial position and results of operations (MD&A).

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all public business entities.

What Are the Main Provisions?

The amendments in this proposed Update would require detailed disclosure, in the notes to financial statements, of specified categories underlying certain expense captions. The proposed amendments would require that an entity on an annual and interim basis:

1. Disclose the amounts of (a) inventory and manufacturing expense, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) depreciation, depletion, and amortization recognized as part of oil- and gas-producing activities (DD&A) included in each relevant expense caption. A relevant expense caption would be an expense caption presented on the face of the income statement within continuing operations that contains any of the expense categories listed in (a)–(e).
2. Disclose a further disaggregation of inventory and manufacturing expense (from 1 above) into the following categories of costs incurred: (a) purchases of inventory, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) DD&A. Costs incurred would include those that are either capitalized to inventory or, if not capitalized to inventory, directly expensed (expensed as incurred) during the current period. On an annual basis, an entity would disclose its definition of other manufacturing expenses.
3. Include certain amounts that are already required to be disclosed under existing generally accepted accounting principles (GAAP) in the same disclosure as the other disaggregation requirements.
4. Disclose a qualitative description of the amounts remaining in relevant expense captions or in inventory and manufacturing expense that are not separately disaggregated quantitatively.
5. Disclose the total amount of selling expenses and, on an annual basis, an entity's definition of selling expenses.

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

The amendments in this proposed Update would improve financial reporting by requiring that public business entities disclose additional information about specific expense categories on an annual and interim basis in the notes to financial statements. This information is generally not presented in the financial statements today.

Currently, Topic 220, Income Statement—Reporting Comprehensive Income, does not require the presentation of specific expense captions on the face of the income statement (excluding the U.S. Securities and Exchange Commission [SEC] Sections). That Topic also does not currently require any disaggregation of expense captions. Certain income statement expense captions are required by industry-specific guidance or are triggered when a specific event occurs (for example, goodwill impairment). Other types of expenses, even when not required to be presented separately on the face of the income statement, are required to be disclosed separately in the notes to financial statements. For public business entities subject to the SEC's presentation requirements, certain articles of SEC Regulation S-X (17 CFR Part 210) apply to entities in different industries. The amendments in this proposed Update would not change or remove those presentation requirements or any other existing presentation requirements.

The amendments in this proposed Update do not change or remove existing expense disclosure requirements. However, the proposed amendments would affect where this information appears in the notes to financial statements because entities would be required to include certain existing disclosures in the same tabular format disclosure as the other disaggregation requirements in the proposed amendments.

What Are the Transition Requirements and When Would the Amendments Be Effective?

The disclosures in this proposed Update would be provided on a prospective basis, with an option for entities to apply the guidance retrospectively.

The Board will determine the effective date and whether early application should be permitted after it considers stakeholders' feedback on the proposed amendments.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Expense Captions Subject to Disaggregation Requirements

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?

Entities in Scope

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

Required Expense Categories

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?

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.

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?

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.

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.

Further Disaggregation of Inventory and Manufacturing Expense

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?

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.

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?

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.

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.

Qualitative Description of Other Items

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.

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.

Interim Reporting

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.

Transition and Effective Date

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.

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.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–7. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Amend the following Master Glossary terms, with a link to transition paragraph 220-40-65-1, as follows:

Employee (second definition)

An individual over whom a reporting entity ~~the grantor of a share-based compensation award~~ exercises or has the right to exercise sufficient control to establish an employer-employee relationship based on common law as illustrated in case law and currently under U.S. Internal Revenue Service (IRS) Revenue Ruling 87-41. A reporting entity based in a foreign jurisdiction would determine whether an employee-employer relationship exists based on the pertinent laws of that jurisdiction. Accordingly, an individual ~~a grantee~~ meets the definition of an employee if the reporting entity ~~grantor~~ consistently represents that individual to be an employee under common law. The definition of an employee for payroll tax purposes under the U.S. Internal Revenue Code includes common law employees. Accordingly, a reporting entity ~~grantor~~ that classifies an individual ~~a grantee~~ potentially subject to U.S. payroll taxes as an employee also must represent that individual as an employee for payroll tax purposes (unless the individual ~~grantee~~ is a leased employee as described below). An individual ~~A grantee~~ does not meet the definition of an employee solely because the reporting entity ~~grantor~~ represents that individual as an employee for some, but not all, purposes. For example, a requirement or decision to classify an individual ~~a grantee~~ as an employee for U.S. payroll tax purposes does not, by itself, indicate that the individual ~~grantee~~ is an employee because the individual ~~grantee~~ also must be an employee of the reporting entity ~~grantor~~ under common law.

A leased individual is deemed to be an employee of the lessee if all of the following requirements are met:

a. The leased individual qualifies as a common law employee of the lessee, and the lessor is contractually required to remit payroll taxes on the compensation paid to the leased individual for the services provided to the lessee.
b. The lessor and lessee agree in writing to all of the following conditions related to the leased individual:
    1. The lessee has the exclusive right to grant ~~stock~~ compensation to the individual for the employee service to the lessee.
    2. The lessee has a right to hire, fire, and control the activities of the individual. (The lessor also may have that right.)
    3. The lessee has the exclusive right to determine the economic value of the services performed by the individual (including wages and the number of units and value of stock compensation granted).
    4. The individual has the ability to participate in the lessee's employee benefit plans, if any, on the same basis as other comparable employees of the lessee.
    5. The lessee agrees to and remits to the lessor funds sufficient to cover the complete compensation, including all payroll taxes, of the individual on or before a contractually agreed upon date or dates.

A nonemployee director does not satisfy this definition of employee. Nevertheless, nonemployee directors acting in their role as members of a board of directors are treated as employees if those directors were elected by the employer's shareholders or appointed to a board position that will be filled by shareholder election when the existing term expires. However, that requirement applies only to awards and other compensation granted to nonemployee directors for their services as directors. Awards granted and compensation paid to those individuals for other services shall be accounted for as awards and compensation to nonemployees.

Natural Expense Classification

A method of grouping expenses according to the types ~~kinds~~ of economic benefits received in incurring those expenses. Examples of natural expense classifications include salaries and wages, employee benefits, nonemployee professional services, supplies, interest expense, rent, utilities, and depreciation.

3. Add the following new Master Glossary terms, with a link to transition paragraph 220-40-65-1, as follows:

Employee Compensation

All forms of cash consideration (including deferred cash compensation), **share-based payment arrangements**, medical care benefits, **pension benefits**, **postretirement benefits**, and **nonretirement postemployment benefits** (including special or contractual **termination benefits**) given by an entity in exchange for service rendered by **employees {2nd definition}** or for the termination of employment. This includes compensation cost arising from wages, salaries, social security contributions, profit-sharing, bonuses, **one-time employee termination benefits**, **other postemployment benefits**, **employee stock ownership plans**, employee share purchase plans, **defined contribution plans**, **multiemployer plans**, and any other compensation cost recognized in accordance with the guidance in Topic 710 on compensation. For **defined benefit plans** within the scope of Topic 715 on retirement benefits, employee compensation includes only the **service cost component of net periodic pension cost** and the **service cost component of net periodic postretirement benefit cost**.

Inventory and Manufacturing Expense

Expenses that comprise both of the following:

a. **Inventory expense**
b. Other manufacturing expenses, if applicable (see paragraph 220-40-50-6).

Inventory Expense

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 Subtopic in Topic 330 on inventory.

Addition of Subtopic 220-40

4. Add Subtopic 220-40, with a link to transition paragraph 220-40-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures

Overview and Background

General

220-40-05-1 This Subtopic provides guidance on the disaggregation disclosure requirements for certain expense captions presented on the face of an entity's income statement. This Subtopic also provides guidance on the disclosure of selling expenses.

Scope and Scope Exceptions

General

> Overall Guidance

220-40-15-1 This Subtopic has its own discrete scope, which is separate and distinct from the pervasive scope for this Topic as outlined in Section 220-10-15.

> Entities

220-40-15-2 The guidance in this Subtopic applies to all **public business entities**.

220-40-15-3 The guidance in this Subtopic does not apply to the following entities:

a. **Private companies**
b. **Not-for-profit entities**
c. Employee benefit plans within the scope of any of the following Topics:
   1. Plan Accounting—Defined Benefit Pension Plans (Topic 960)
   2. Plan Accounting—Defined Contribution Pension Plans (Topic 962)
   3. Plan Accounting—Health and Welfare Benefit Plans (Topic 965).

Glossary

Accretion Expense

An amount recognized as an expense classified as an operating item in the statement of income resulting from the increase in the carrying amount of the liability associated with the asset retirement obligation.

Acquiree

The **business** or **businesses** that the **acquirer** obtains control of in a **business combination**. This term also includes a nonprofit activity or business that a not-for-profit acquirer obtains control of in an **acquisition by a not-for-profit entity**.

Acquirer

The entity that obtains control of the **acquiree**. However, in a **business combination** in which a **variable interest entity** (VIE) is acquired, the primary beneficiary of that entity always is the acquirer.

Acquisition by a Not-for-Profit Entity

A transaction or other event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and initially recognizes their assets and liabilities in the acquirer's financial statements. When applicable guidance in Topic 805 is applied by a **not-for-profit entity**, the term **business combination** has the same meaning as this term has for a for-profit entity. Likewise, a reference to business combinations in guidance that links to Topic 805 has the same meaning as a reference to acquisitions by not-for-profit entities.

Asset Retirement Obligation

An obligation associated with the retirement of a tangible long-lived asset.

Business

Paragraphs 805-10-55-3A through 55-6 and 805-10-55-8 through 55-9 define what is considered a business.

Business Combination

A transaction or other event in which an **acquirer** obtains control of one or more **businesses**. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations. See also **Acquisition by a Not-for-Profit Entity**.

Commencement Date of the Lease (Commencement Date)

The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**. See paragraphs 842-10-55-19 through 55-21 for implementation guidance on the commencement date.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Customer

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Defined Benefit Plan

A defined benefit plan provides participants with a determinable benefit based on a formula provided for in the plan.

a. Defined benefit health and welfare plans—Defined benefit health and welfare plans specify a determinable benefit, which may be in the form of a reimbursement to the covered plan participant or a direct payment to providers or third-party insurers for the cost of specified services. Such plans may also include benefits that are payable as a lump sum, such as death benefits. The level of benefits may be defined or limited based on factors such as age, years of service, and salary. Contributions may be determined by the plan's actuary or be based on premiums, actual claims paid, hours worked, or other factors determined by the plan sponsor. Even when a plan is funded pursuant to agreements that specify a fixed rate of employer contributions (for example, a collectively bargained multiemployer plan), such a plan may nevertheless be a defined benefit health and welfare plan if its substance is to provide a defined benefit.
b. Defined benefit pension plan—A pension plan that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation. Any pension plan that is not a **defined contribution** pension plan is, for purposes of Subtopic 715-30, a defined benefit pension plan.
c. Defined benefit postretirement plan—A plan that defines postretirement benefits in terms of monetary amounts (for example, $100,000 of life insurance) or benefit coverage to be provided (for example, up to $200 per day for hospitalization, or 80 percent of the cost of specified surgical procedures). Any postretirement benefit plan that is not a defined contribution postretirement plan is, for purposes of Subtopic 715-60, a defined benefit postretirement plan. (Specified monetary amounts and benefit coverage are collectively referred to as benefits.)

Defined Contribution Plan

A plan that provides an individual account for each participant and provides benefits that are based on all of the following: amounts contributed to the participant’s account by the employer or employee; investment experience; and any forfeitures allocated to the account, less any administrative expenses charged to the plan.

a. Defined contribution health and welfare plans—Defined contribution health and welfare plans maintain an individual account for each plan participant. They have terms that specify the means of determining the contributions to participants’ accounts, rather than the amount of benefits the participants are to receive. The benefits a plan participant will receive are limited to the amount contributed to the participant’s account, investment experience, expenses, and any forfeitures allocated to the participant’s account. These plans also include flexible spending arrangements.
b. Defined contribution postretirement plan—A plan that provides postretirement benefits in return for services rendered, provides an individual account for each plan participant, and specifies how contributions to the individual’s account are to be determined rather than specifies the amount of benefits the individual is to receive. Under a defined contribution postretirement plan, the benefits a plan participant will receive depend solely on the amount contributed to the plan participant’s account, the returns earned on investments of those contributions, and the forfeitures of other plan participants’ benefits that may be allocated to that plan participant’s account.

Derivative Instrument

Paragraphs 815-10-15-83 through 15-139 define the term *derivative instrument*.

Direct Financing Lease

From the perspective of a **lessor**, a **lease** that meets none of the criteria in paragraph 842-10-25-2 but meets the criteria in paragraph 842-10-25-3(b) and is not an operating lease in accordance with paragraph 842-10-25-3A.

Employee (second definition)

An individual over whom a reporting entity exercises or has the right to exercise sufficient control to establish an employer-employee relationship based on common law as illustrated in case law and currently under U.S. Internal Revenue Service (IRS) Revenue Ruling 87-41. A reporting entity based in a foreign jurisdiction would determine whether an employee-employer relationship exists based on the pertinent laws of that jurisdiction. Accordingly, an individual meets the definition of an employee if the reporting entity consistently represents that individual to be an employee under common law. The definition of an employee for payroll tax purposes under the U.S. Internal Revenue Code includes common law employees. Accordingly, a reporting entity that classifies an individual potentially subject to U.S. payroll taxes as an employee also must represent that individual as an employee for payroll tax purposes (unless the individual is a leased employee as described below). An individual does not meet the definition of an employee solely because the reporting entity represents that individual as an employee for some, but not all, purposes. For example, a requirement or decision to classify an individual as an employee for U.S. payroll tax purposes does not, by itself, indicate that the individual is an employee because the individual also must be an employee of the reporting entity under common law.

A leased individual is deemed to be an employee of the lessee if all of the following requirements are met:

a. The leased individual qualifies as a common law employee of the lessee, and the lessor is contractually required to remit payroll taxes on the compensation paid to the leased individual for the services provided to the lessee.
b. The lessor and lessee agree in writing to all of the following conditions related to the leased individual:
    1. The lessee has the exclusive right to grant compensation to the individual for the employee service to the lessee.
    2. The lessee has a right to hire, fire, and control the activities of the individual. (The lessor also may have that right.)
    3. The lessee has the exclusive right to determine the economic value of the services performed by the individual (including wages and the number of units and value of stock compensation granted).
    4. The individual has the ability to participate in the lessee’s employee benefit plans, if any, on the same basis as other comparable employees of the lessee.
    5. The lessee agrees to and remits to the lessor funds sufficient to cover the complete compensation, including all payroll taxes, of the individual on or before a contractually agreed upon date or dates.

A nonemployee director does not satisfy this definition of employee. Nevertheless, nonemployee directors acting in their role as members of a board of directors are treated as employees if those directors were elected by the employer's shareholders or appointed to a board position that will be filled by shareholder election when the existing term expires. However, that requirement applies only to awards and other compensation granted to nonemployee directors for their services as directors. Awards granted and compensation paid to those individuals for other services shall be accounted for as awards and compensation to nonemployees.

Employee Compensation

All forms of cash consideration (including deferred cash compensation), **share-based payment arrangements**, medical care benefits, **pension benefits**,

postretirement benefits, and **nonretirement postemployment benefits** (including special or contractual **termination benefits**) given by an entity in exchange for service rendered by **employees {2nd definition}** or for the termination of employment. This includes compensation cost arising from wages, salaries, social security contributions, profit-sharing, bonuses, **one-time employee termination benefits**, **other postemployment benefits**, **employee stock ownership plans**, employee share purchase plans, **defined contribution plans**, **multiemployer plans**, and any other compensation cost recognized in accordance with the guidance in Topic 710 on compensation. For **defined benefit plans** within the scope of Topic 715 on retirement benefits, employee compensation includes only the **service cost component of net periodic pension cost** and the **service cost component of net periodic postretirement benefit cost**.

Employee Stock Ownership Plan

An employee stock ownership plan is an employee benefit plan that is described by the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986 as a stock bonus plan, or combination stock bonus and money purchase pension plan, designed to invest primarily in employer stock. Also called an employee share ownership plan.

Film Costs

Film costs include all direct negative costs incurred in the physical production of a film, as well as allocations of production overhead and capitalized interest in accordance with Topic 835. Examples of direct negative costs include costs of story and scenario; compensation of cast, directors, producers, extras, and miscellaneous staff; costs of set construction and operations, wardrobe, and accessories; costs of sound synchronization; rental facilities on location; and postproduction costs such as music, special effects, and editing.

Finance Lease

From the perspective of a **lessee**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2.

Hosting Arrangement

In connection with accessing and using software products, an arrangement in which the customer of the software does not currently have possession of the software; rather, the customer accesses and uses the software on an as-needed basis.

Impairment

Impairment is the condition that exists when the carrying amount of a long-lived asset (asset group) exceeds its fair value.

Inactive Employees

Employees who are not currently rendering service to the employer and who have not been terminated. They include those who have been laid off and those on disability leave, regardless of whether they are expected to return to active status.

Intangible Assets

Assets (not including financial assets) that lack physical substance. (The term intangible assets is used to refer to intangible assets other than goodwill.)

Inventory

The aggregate of those items of tangible personal property that have any of the following characteristics:

a. Held for sale in the ordinary course of business
b. In process of production for such sale
c. To be currently consumed in the production of goods or services to be available for sale.

The term inventory embraces goods awaiting sale (the merchandise of a trading concern and the finished goods of a manufacturer), goods in the course of production (work in process), and goods to be consumed directly or indirectly in production (raw materials and supplies). This definition of inventories excludes long-term assets subject to depreciation accounting, or goods which, when put into use, will be so classified. The fact that a depreciable asset is retired from regular use and held for sale does not indicate that the item should be classified as part of the inventory. Raw materials and supplies purchased for production may be used or consumed for the construction of long-term assets or other purposes not related to production, but the fact that inventory items representing a small portion of the total may not be absorbed ultimately in the production process does not require separate classification. By trade practice, operating materials and supplies of certain types of entities such as oil producers are usually treated as inventory.

Inventory and Manufacturing Expense

Expenses that comprise both of the following:

a. **Inventory expense**

b. Other manufacturing expenses, if applicable (see paragraph 220-40-50-6)

Inventory Expense

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 Subtopic in Topic 330 on inventory.

Lease

A **contract**, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

Lease Term

The noncancellable period for which a **lessee** has the right to use an **underlying asset**, together with all of the following:

a. Periods covered by an option to extend the **lease** if the lessee is reasonably certain to exercise that option
b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the **lessor**.

Legal Entity

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

Lessee

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

Lessor

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

License Agreement

A typical license agreement for program material (for example, features, specials, series, or cartoons) covers several programs (a package) and grants a television station, group of stations, network, pay television, or cable television system (licensee) the right to broadcast either a specified number or an unlimited number of showings over a maximum period of time (license period) for a specified fee.

Loss Contingency

An existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. The term loss is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses.

Multiemployer Plan

A pension or postretirement benefit plan to which two or more unrelated employers contribute, usually pursuant to one or more collective-bargaining agreements. A characteristic of multiemployer plans is that assets contributed by one participating employer may be used to provide benefits to employees of other participating employers since assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer. A multiemployer plan is usually administered by a board of trustees composed of management and labor representatives and may also be referred to as a joint trust or union plan. Generally, many employers participate in a multiemployer plan, and an employer may participate in more than one plan. The employers participating in multiemployer plans usually have a common industry bond, but for some plans the employers are in different industries and the labor union may be their only common bond. Some multiemployer plans do not involve a union. For example, local chapters of a not-for-profit entity (NFP) may participate in a plan established by the related national organization.

Natural Expense Classification

A method of grouping expenses according to the types of economic benefits received in incurring those expenses. Examples of natural expense classifications include salaries and wages, employee benefits, nonemployee professional services, supplies, interest expense, rent, utilities, and depreciation.

Nonretirement Postemployment Benefits

All types of benefits, other than those provided through a pension or other postretirement plan (see Subtopics 715-30 and 715-60), provided to former or inactive employees, their beneficiaries, and covered dependents.

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
b. Operating purposes other than to provide goods or services at a profit
c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

a. All investor-owned entities
b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Oil- and Gas-Producing Activities

Paragraph 932-10-15-2A defines the term *oil- and gas-producing activities*.

One-Time Employee Termination Benefits

Benefits provided to current employees that are involuntarily terminated under the terms of a one-time benefit arrangement.

Operating Lease

From the perspective of a **lessee**, any **lease** other than a **finance lease**.

From the perspective of a **lessor**, any lease other than a **sales-type lease** or a **direct financing lease**.

Other Postemployment Benefits

Benefits, other than special or contractual termination benefits, that are provided by an employer to former or **inactive employees** after employment but before retirement including benefits provided to beneficiaries and covered dependents.

Pension Benefits

Periodic (usually monthly) payments made pursuant to the terms of the pension plan to a person who has retired from employment or to that person's beneficiary.

Postretirement Benefits

All forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, that are provided to retirees as the need for those benefits arises, such as certain health care benefits, or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits.

Private Company

An entity other than a **public business entity**, a **not-for-profit entity**, or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting.

Public Business Entity

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit entity** nor an employee benefit plan is a business entity.

a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
d. It has issued, or is a conduit bond obligor for, **securities** that are traded, listed, or quoted on an exchange or an over-the-counter market.
e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including notes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Reinsurance

A transaction in which a reinsurer (assuming entity), for a consideration (premium), assumes all or part of a risk undertaken originally by another insurer (ceding entity). For indemnity reinsurance, the legal rights of the insured are not affected by the reinsurance transaction and the insurance entity issuing the insurance contract remains liable to the insured for payment of policy benefits. Assumption or novation reinsurance contracts that are legal replacements of one insurer by another extinguish the ceding entity's liability to the policyholder.

Right-of-Use Asset

An asset that represents a **lessee's** right to use an **underlying asset** for the **lease term**.

Sales-Type Lease

From the perspective of a **lessor**, a **lease** that meets one or more of the criteria in paragraph 842-10-25-2 and is not an operating lease in accordance with paragraph 842-10-25-3A.

Security (second definition)

A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Service Cost (Component of Net Periodic Pension Cost)

A component of net periodic pension cost recognized in a period determined as the actuarial present value of benefits attributed by the pension benefit formula to services rendered by employees during that period.

The service cost component is a portion of the projected benefit obligation and is unaffected by the funded status of the plan.

Service Cost (Component of Net Periodic Postretirement Benefit Cost)

The actuarial present value of benefits attributed to services rendered by employees during the period (the portion of the expected postretirement benefit obligation attributed to service in the period). The service cost component is the same for an unfunded plan, a plan with minimal funding, and a well-funded plan.

Share-Based Payment Arrangements

An arrangement under which either of the following conditions is met:

a. One or more suppliers of goods or services (including employees) receive awards of equity shares, equity share options, or other equity instruments.
b. The entity incurs liabilities to suppliers that meet either of the following conditions:
    1. The amounts are based, at least in part, on the price of the entity's shares or other equity instruments. (The phrase at least in part is used because an award may be indexed to both the price of the entity's shares and something other than either the price of the entity's shares or a market, performance, or service condition.)
    2. The awards require or may require settlement by issuance of the entity's shares.

The term shares includes various forms of ownership interest that may not take the legal form of securities (for example, partnership interests), as well as other interests, including those that are liabilities in substance but not in form. Equity shares refers only to shares that are accounted for as equity.

Also called share-based compensation arrangements.

Short-Term Lease

A **lease** that, at the **commencement date**, has a **lease term** of 12 months or less and does not include an option to purchase the **underlying asset** that the **lessee** is reasonably certain to exercise.

Subsidiary

An entity, including an unincorporated entity such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest. (Also, a variable interest entity that is consolidated by a primary beneficiary.)

Termination Benefits

Benefits provided by an employer to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs.

Transaction Gain or Loss

Transaction gains or losses result from a change in exchange rates between the functional currency and the currency in which a foreign currency transaction is denominated. They represent an increase or decrease in both of the following:

a. The actual functional currency cash flows realized upon settlement of foreign currency transactions
b. The expected functional currency cash flows on unsettled foreign currency transactions.

Troubled Debt Restructuring

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.

Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

Underwriting Risk

The risk arising from uncertainties about the ultimate amount of net cash flows from premiums, commissions, claims, and claim settlement expenses paid under a contract.

Variable Interest Entity

A **legal entity** subject to consolidation according to the provisions of the Variable Interest Entities Subsections of Subtopic 810-10.

Warranty

A guarantee for which the underlying is related to the performance (regarding function, not price) of nonfinancial assets that are owned by the guaranteed party.

The obligation may be incurred in connection with the sale of goods or services; if so, it may require further performance by the seller after the sale has taken place.

Disclosure

General

> Overall Guidance

220-40-50-1 The objective of the disclosure requirements in this Section is to provide disaggregated information about a **public business entity's** expenses to help investors:

a. Better understand the entity's performance
b. Better assess the entity's prospects for future cash flows
c. Compare an entity's performance over time and with that of other entities.

220-40-50-2 This Section includes the following (all of which apply only to expenses in continuing operations):

a. Required expense categories to be disclosed and identification of relevant expense captions (see paragraphs 220-40-50-4 through 50-11)
b. Tabular integration of other disclosure requirements (see paragraphs 220-40-50-12 through 50-15)
c. An amount and qualitative description of the composition of other items remaining in relevant expense captions (see paragraph 220-40-50-16)
d. Further disaggregated disclosure of **inventory and manufacturing expense** into categories that represent costs incurred that are either capitalized to **inventory** or expensed during the current reporting period (see paragraphs 220-40-50-17 through 50-21)
e. Requirements related to selling expenses (see paragraphs 220-40-50-22 through 50-23).

220-40-50-3 The requirements in this Section apply to both annual and interim reporting periods, except for the requirements to disclose how an entity defines other manufacturing expenses (see paragraph 220-40-50-6) and selling expenses (see paragraph 220-40-50-23), which only apply to annual reporting periods. An entity is required to include only the disclosures listed in paragraphs 220-40-50-12 through 50-13 in a tabular format disclosure for interim reporting purposes if the disclosure requirements referenced in those paragraphs are required in interim reporting periods.

• > Expense Disaggregation Disclosures

220-40-50-4 An entity shall, in a tabular format disclosure in the notes to financial statements, disaggregate all relevant expense captions (see paragraph 220-40-50-10 for guidance on identifying relevant expense captions) presented on the face of the income statement in continuing operations into the following expense categories:

a. Inventory and manufacturing expense (see paragraph 220-40-50-5)
b. **Employee compensation** (disclosing separately any **one-time employee termination benefits**, if applicable, see paragraph 220-40-50-12(e))
c. Depreciation (for separate requirement to disclose depreciation expense for the period in total, see paragraph 360-10-50-1(a))
d. **Intangible asset** amortization (for separate requirement to disclose intangible asset amortization expense for the period in total, see paragraph 350-30-50-2(a)(2))
e. Depreciation, depletion, and amortization of capitalized acquisition, exploration, and development costs recognized as part of **oil- and gas-producing activities** (see Subtopic 932-360 on extractive activities—oil and gas—property, plant, and equipment).

220-40-50-5 Inventory and manufacturing expense comprises both of the following:

a. **Inventory expense**
b. Other manufacturing expenses, if applicable (see paragraph 220-40-50-6).

220-40-50-6 An entity shall exercise judgment to determine which, if any, expenses are other manufacturing expenses for the purpose of applying the requirements to disclose inventory and manufacturing expense separately from other expense categories in accordance with paragraphs 220-40-50-4(a) and 220-40-50-5. Other manufacturing expenses generally include, but are not limited to, certain costs incurred as part of an entity's manufacturing activities that are not capitalizable (for example, unallocated manufacturing overhead related to abnormally low production). An entity shall disclose how it defines other manufacturing expenses. All other costs expensed as incurred shall not be included in inventory and manufacturing expense and, therefore, are subject to the requirements in paragraph 220-40-50-4(b) through (e) rather than the requirements in paragraphs 220-40-50-17 through 50-18.

220-40-50-7 When applying the guidance in paragraph 220-40-50-4(b), an entity may elect, but is not required, to include amounts attributable to other transactions entered into for the benefit of employees (for example, the provision of subsidized goods or services) in employee compensation. An entity shall apply this election consistently. An entity that includes other transactions entered into for the benefit of employees as part of employee compensation shall disclose both that those transactions have been included and a description of those transactions.

220-40-50-8 The amounts provided for depreciation in accordance with paragraph 220-40-50-4(c) and intangible asset amortization in accordance with paragraph 220-40-50-4(d) shall be consistent with the classification of amounts used to satisfy the disclosure requirements for the total depreciation expense and total intangible asset amortization expense disclosures in paragraphs 360-10-50-1(a) and 350-30-50-2(a)(2), respectively, and with the classification of amounts described in paragraph 220-40-50-9.

220-40-50-9 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).

• • > Identification of Relevant Expense Captions

220-40-50-10 For the purposes of applying the guidance in this Subtopic, a relevant expense caption is an expense caption presented on the face of the income statement in continuing operations that contains any of the expenses listed in paragraph 220-40-50-4 (including those described in paragraph 220-40-50-9).

• • > Practical Expedient for Employee Compensation

220-40-50-11 As a practical expedient for determining what amounts are classified as employee compensation in paragraph 220-40-50-4(b), an entity that presents an expense caption for salaries and employee benefits (or a similarly named caption) on the face of its income statement to comply with the requirements in SEC Regulation S-X Rule 9-04 (see paragraph 942-220-S99-1) may use the amounts classified as salaries and employee benefits in accordance with Rule 9-04 rather than in accordance with the definition of employee compensation included in this Subtopic.

• > Tabular Integration of Other Disclosure Requirements

220-40-50-12 An entity, in the same tabular format disclosure in which the disclosures required by paragraph 220-40-50-4 are provided, shall disclose each of the following expenses, gains, and losses and the amount recognized in each relevant expense caption, if applicable:

a. The amount of research and development assets acquired in a transaction other than a business combination and written off (see paragraph 350-30-50-1(c))
b. Impairment loss recognized related to an intangible asset (see paragraph 350-30-50-3)
c. **Impairment** loss of long-lived assets classified as held and used (see paragraph 360-10-50-2)
d. Gain or loss recognized in accordance with paragraphs 360-10-35-37 through 35-45 and 360-10-40-5 for long-lived assets classified as held for sale or disposed of (see paragraph 360-10-50-3)
e. Each major type of cost associated with an exit or disposal activity (for example, one-time employee termination benefits, contract termination costs, and other associated costs) (see paragraph 420-10-50-1)
f. Bargain purchase gain recognized in a **business combination** (see paragraph 805-30-50-1)
g. Any gain or loss recognized upon the deconsolidation of a **subsidiary** or the derecognition of a group of assets in accordance with paragraph 810-10-40-3A (see paragraph 810-10-50-1B)
h. Gains and losses on **derivative instruments** and related hedged items (see paragraph 815-10-50-4A)
i. Amortization of **license agreements** for program material (see paragraph 920-350-50-2)
j. Impairment of license agreements for program material (see paragraph 920-350-50-4)
k. Amortization of **film costs** (see paragraph 926-20-50-4A)
l. Impairment of film costs (see paragraph 926-20-50-4C).

220-40-50-13 An entity, in the same tabular format disclosure in which the disclosures required by paragraph 220-40-50-4 are provided, shall disclose each of the following amounts if those amounts are included entirely in one expense caption that also is a relevant expense caption (see paragraph 220-40-50-10 for guidance on identifying relevant expense captions):

a. Provision for expected credit losses (see paragraphs 326-20-50-13 and 326-30-50-9)
b. Losses on firm purchase commitments (see paragraph 330-10-50-5)
c. Amortization expense attributable to the expiration of an insurance or **reinsurance** coverage provided under a contract that transfers only significant **underwriting risk** (see paragraph 340-30-50-2)
d. Amortization of costs to fulfill a **contract** with a **customer** (see paragraph 340-40-50-3)
e. Impairment of costs to fulfill a contract with a customer (see paragraph 340-40-50-3)
f. Amortization of costs to obtain a contract with a customer (see paragraph 340-40-50-3)

g. Impairment of costs to obtain a contract with a customer (see paragraph 340-40-50-3)
h. Amortization of capitalized implementation costs of **hosting arrangements** that are service contracts (see paragraph 350-40-50-3)
i. **Asset retirement obligation accretion expense** (see paragraph 410-20-50-1)
j. **Loss contingencies** recognized (see paragraph 450-20-50-1)
k. **Warranty** expense (the total of expenses recognized related to aggregate changes in the liability for accruals related to product warranties issued during the reporting period and the aggregate changes in the liability for accruals related to preexisting warranties, including adjustments related to changes in estimates) (see paragraph 460-10-50-8)
l. Expense related to counterparty default in own-share lending arrangements issued in contemplation of convertible debt issuance (see paragraph 470-20-50-2C)
m. Aggregate gain on restructuring of payable by a debtor with a **troubled debt restructuring** (see paragraph 470-60-50-1)
n. Gains and losses upon consolidation of a **variable interest entity** that is not a business (see paragraph 810-10-50-3)
o. Foreign currency **transaction gains or losses** (see paragraph 830-20-50-1)
p. **Operating lease** cost (see paragraph 842-20-50-4)
q. **Short-term lease** cost (see paragraph 842-20-50-4)
r. Variable lease cost (see paragraph 842-20-50-4)
s. Net gain or loss recognized from sale and leaseback transactions (see paragraph 842-20-50-4)
t. Gains and losses from nonmonetary transactions (see paragraph 845-10-50-1).

220-40-50-14 The presence of the expenses listed in paragraphs 220-40-50-12 through 50-13 would not cause an expense caption to be a relevant expense caption. An entity only shall include the applicable expenses listed in paragraphs 220-40-50-12 through 50-13 in the tabular format disclosures if an expense caption is a relevant expense caption in accordance with paragraph 220-40-50-10.

220-40-50-15 To illustrate the application of the requirements in paragraph 220-40-50-13, if cost of sales was a relevant expense caption (because cost of sales includes inventory and manufacturing expense described in paragraph 220-40-50-4(a)) and if amortization of costs to fulfill a contract with a customer was recognized entirely in cost of sales and not in multiple expense captions presented on the face of the income statement, then amortization of costs to fulfill a contract with a customer would be required to be included as a separate category in the tabular format disclosure in addition to the categories required by paragraph 220-40-50-4.

• > Other Items Remaining in Relevant Expense Captions

220-40-50-16 An entity shall, in the same tabular format disclosure in which the disclosures required by paragraph 220-40-50-4 are provided, disclose for each relevant expense caption an amount for other items. The amount for other items is the difference between the following:

a. The amount of the relevant expense caption presented on the face of the income statement
b. The aggregate amount of expense categories separately disclosed in accordance with paragraphs 220-40-50-4 and 220-40-50-12 through 50-13 that are included in the relevant expense caption.

An entity also shall disclose qualitative descriptions of the composition (based on their **natural expense classification**) of other items. The detail provided in those qualitative disclosures shall be commensurate with the significance of the amounts being described. Notwithstanding that requirement, an entity is not precluded from providing further disaggregation of relevant expense captions before applying the guidance in this paragraph to the remaining other items.

• > Further Disaggregation of Inventory and Manufacturing Expense

220-40-50-17 An entity that discloses inventory and manufacturing expense in accordance with paragraph 220-40-50-4(a) shall, in a tabular format disclosure in the notes to financial statements, provide additional disaggregation of inventory and manufacturing expense. The amounts disclosed shall comprise any costs incurred that were capitalized to inventory during the current period and any manufacturing costs incurred that were directly expensed during the current period, with accompanying disclosure of captions for changes in inventories and other adjustments and reconciling items to reconcile the amounts of costs incurred to the amounts of expenses recognized (see paragraphs 220-40-50-19 through 50-21). Amounts representing costs that are not capitalized to inventory because they are expensed as incurred shall be included in this disaggregation only if they relate to an entity's manufacturing activities (see paragraph 220-40-50-6 for guidance on determining what activities constitute other manufacturing activities). All other costs expensed as incurred shall not be included in inventory and manufacturing expense and, therefore, are subject to the requirements in paragraph 220-40-50-4(b) through (e) rather than the requirements in paragraph 220-40-50-18.

220-40-50-18 When further disaggregating inventory and manufacturing expense in accordance with paragraph 220-40-50-17, an entity shall provide the following categories of costs incurred and amounts that reconcile costs incurred to expenses recognized:

a. Purchases of inventory (including the amount of inventory recognized as part of an asset acquisition, business combination, or upon initial consolidation of a variable interest entity that is not a **business**)
b. Employee compensation (see paragraph 220-40-50-4(b))
c. Depreciation (see paragraph 220-40-50-4(c))
d. Intangible asset amortization (see paragraph 220-40-50-4(d))
e. Depreciation, depletion, and amortization of capitalized acquisition, exploration, and development costs recognized as part of oil- and gas-producing activities (see Subtopic 932-360 on extractive activities—oil and gas—property, plant, and equipment and paragraph 220-40-50-4(e))
f. Costs capitalized to inventory and manufacturing expenses not included in the categories listed in paragraph 220-40-50-18(a) through (e) (see paragraph 220-40-50-21)
g. Changes in inventories (see paragraph 220-40-50-19)
h. Other adjustments and reconciling items (see paragraph 220-40-50-20).

• • > Changes in Inventories

220-40-50-19 The amount of inventory and manufacturing expense recognized during a reporting period and the amount of costs incurred that are either capitalized to inventory or expensed as incurred during the reporting period will generally not be equal. If the amount of inventory expense recognized and the amount of costs capitalized to inventory in the current period are not equal, then an entity shall provide a category for the change in inventory balances to reconcile the costs incurred (which shall include both costs capitalized to inventory and costs expensed during the reporting period) to expenses recognized. The amount disclosed for changes in inventories in the current period shall equal the difference between the amount of inventory included on the balance sheet presented at the end of the prior period and the amount of inventory included on the balance sheet presented at the end of the current period. As described in paragraph 220-40-50-20, a separate category that comprises any other adjustments and reconciling items shall be provided to reconcile costs incurred to expenses recognized.

• • > Other Adjustments and Reconciling Items and Other Costs Capitalized to Inventory and Other Manufacturing Expenses

220-40-50-20 The disclosed amount of other adjustments and reconciling items shall include (if not disclosed in a separate caption) other amounts that are necessary to reconcile costs incurred to expenses recognized because paragraph 220-40-50-21 requires that an entity compute the amount for the changes in inventories category using the amounts of inventories presented on the current-period and prior-period balance sheets. For example, those items would include, if applicable:

a. The amount of inventory derecognized during the period that does not meet the definition of inventory expense (for example, inventory derecognized as part of derecognition transactions within the scope of Subtopic 810-10 on consolidation)
b. The amount attributable to differences in the foreign currency exchange rates used to translate costs incurred, the beginning balance of inventory, and the ending balance of inventory in accordance with Subtopic 830-30 on foreign currency matters—translation of financial statements.

220-40-50-21 An entity shall qualitatively describe the nature of amounts (based on their natural expense classification when applicable) included in either of the following captions:

a. Costs capitalized to inventory and manufacturing expenses not included in the categories listed in paragraph 220-40-50-18(a) through (e) (see paragraph 220-40-50-18(f))
b. Other adjustments and reconciling items (see paragraph 220-40-50-20).

• > Selling Expenses

220-40-50-22 An entity shall disclose, in the notes to financial statements, the total selling expenses recognized in continuing operations.

220-40-50-23 An entity shall make its own determination of what constitutes a selling expense and disclose how it defines selling expenses.

Implementation Guidance and Illustrations

General

220-40-55-1 This Section is an integral part of the requirements of this Subtopic. This Section provides additional guidance and illustrations of the disaggregation of income statement expenses and other disclosures required by paragraphs 220-40-50-1 through 50-23. The illustrations are intended as examples only and do not represent a required format for the disclosure. Paragraphs 220-40-50-4, 220-40-50-12 through 50-13, and 220-40-50-17 through 50-18 require that an entity provide certain disclosures in a tabular format disclosure.

> Implementation Guidance

• > Disaggregation of Expenses

220-40-55-2 An entity that includes any of the expenses (other than **inventory and manufacturing expense**) listed in paragraph 220-40-50-4 or paragraphs 220-40-50-12 through 50-13 in the tabular format disclosure is not required to further disaggregate those expenses into the categories required by paragraph 220-40-50-4. Inventory and manufacturing expense shall be disaggregated in accordance with paragraphs 220-40-50-17 through 50-21.

220-40-55-3 For example, if amortization of costs to fulfill a **contract** with a **customer** is required to be provided in the tabular format disclosure because it is included entirely in one expense caption that also is a relevant expense caption, then an entity is not required to further disaggregate amortization of costs to fulfill a contract with a customer into the categories required by paragraph 220-40-50-3 (for example, **employee compensation**). As another example, an entity that capitalizes 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.

> Illustrations

• > Example 1: Disaggregation of Income Statement Expenses by an Entity with Manufacturing and Service Operations

220-40-55-4 This Example illustrates one type of tabular format disclosure that an entity could use to disclose disaggregated expense amounts in accordance with paragraphs 220-40-50-1 through 50-21. This Example also illustrates the disclosure of selling expenses in accordance with paragraphs 220-40-50-22 through 50-23.

220-40-55-5 For the year ended December 31, 20X3, Entity XYZ, which is a manufacturer with significant service operations, presents the following comparative statement of operations.

Entity XYZ
Consolidated Statement of Operations
For the Years Ended December 31, 20X3, 20X2, and 20X1

	20X3	20X2	20X1
Revenues:			
Products	$ 82,144	$ 79,137	$ 75,180
Services	26,132	23,146	21,989
Total revenues	108,276	102,283	97,169
Operating expenses:			
Cost of products sold	63,456	60,898	57,244
Cost of services	10,496	9,568	8,898
Selling, general, and administrative	20,849	18,871	18,116
Total operating expenses	94,801	89,337	84,258
Operating income	13,475	12,946	12,911
Interest expense	4,971	4,213	4,297
Income before income taxes	8,504	8,733	8,614
Income tax expense	1,786	1,834	1,809
Net income	$ 6,718	$ 6,899	$ 6,805

220-40-55-6 Entity XYZ provides a disclosure that disaggregates the cost of products sold, cost of services, and selling, general, and administrative expense captions into the categories listed in paragraph 220-40-50-4. Those expense captions were identified as relevant expense captions because those captions contain one or more of the expense categories listed in paragraph 220-40-50-4. Even though Entity XYZ presents other expense captions on the face of its consolidated statement of operations, such as interest expense and income tax expense, those expense captions do not contain any of the expense categories listed in paragraph 220-40-50-4 (including those described in paragraph 220-40-50-9), so those expense captions do not need to be disaggregated.

220-40-55-7 In addition to the categories listed in paragraph 220-40-50-4, Entity XYZ further disaggregates inventory and manufacturing expense in accordance with the requirements in paragraphs 220-40-50-17 through 50-21. In accordance with paragraph 220-40-50-21, Entity XYZ qualitatively describes the nature of amounts included in other costs capitalized to **inventory** and other manufacturing expenses and other adjustments and reconciling items.

220-40-55-8 Entity XYZ also recognizes **impairment** of property, plant, and equipment classified as held and used in selling, general, and administrative expenses and, therefore, includes this impairment as a separate category in the tabular format disclosure in accordance with paragraph 220-40-50-12.

220-40-55-9 Entity XYZ recognizes expenses associated with **warranty** accruals entirely within cost of products sold and, therefore, includes warranty expense as a separate category in accordance with paragraph 220-40-50-13.

220-40-55-10 Entity XYZ recognizes **operating lease** cost in both cost of services and selling, general, and administrative expenses. Therefore, in accordance with paragraph 220-40-50-13, Entity XYZ is not required to separately disclose the amounts of cost of services and selling, general, and administrative expenses that are attributable to operating lease cost. Instead, those expenses are included in the amount for other items for each relevant expense caption in accordance with paragraph 220-40-50-16.

220-40-55-11 Entity XYZ provides the following disclosure.

Disaggregation of Relevant Expense Captions

Cost of products sold

Cost of products sold	20X3	20X2	20X1
Inventory and manufacturing expense [(a)]	$ 53,688	$ 51,935	$ 48,680
Employee compensation	2,046	1,827	1,279
Depreciation	1,395	1,311	1,232
Warranty expense	4,394	3,952	3,894
Other cost of products sold [(b)]	1,933	1,873	2,159
Total cost of products sold	$ 63,456	$ 60,898	$ 57,244

(a) The company defines manufacturing expenses (other than inventory expense) as those that are incurred for the purpose of producing units of inventory, but are not capitalizable. Other manufacturing expenses include costs incurred related to idled manufacturing plants.

(b) Other cost of products sold consisted primarily of amounts paid to carriers for freight services related to contract fulfillment for the years ended December 31, 20X3, 20X2, and 20X1.

Cost of products sold: inventory and manufacturing expense			
Purchases of inventory	$ 20,213	$ 19,199	$ 16,319
Employee compensation	15,532	14,712	12,799
Depreciation	8,795	8,678	8,418
Intangible asset amortization	3,914	4,050	3,929
Other inventory and manufacturing costs (directly expensed or capitalized to inventory) [(c)]	5,619	5,733	5,834
Total inventory and manufacturing costs (directly expensed or capitalized to inventory)	54,073	52,372	47,299
Other adjustments and reconciling items [(d)]	(542)	424	538
Changes in inventories	157	(861)	843
Total inventory and manufacturing expense	$ 53,688	$ 51,935	$ 48,680

(c) Other inventory and manufacturing costs consisted primarily of power, fuel, and other utilities costs for the years ended December 31, 20X3, 20X2, and 20X1.

(d) Other adjustments and reconciling Items consisted of reconciling adjustments attributable to differences in the foreign exchange rates used to translate beginning inventory, ending inventory, and costs incurred from various functional currencies into the reporting currency for the years ended December 31, 20X3, 20X2, and 20X1. For the year ended December 31, 20X3, other adjustments and reconciling items also included the carrying amount of inventory sold to noncustomers in connection with a disposal transaction.

Cost of services

Cost of services			
Employee compensation	$ 6,598	$ 5,654	$ 4,354
Depreciation	763	765	742
Intangible asset amortization	642	670	650
Other cost of services [(e)]	2,493	2,479	3,152
Total cost of services	$ 10,496	$ 9,568	$ 8,898

(e) Other cost of services consisted primarily of operating lease and travel costs for the years ended December 31, 20X3, 20X2, and 20X1.

Selling, general, and administrative

Selling, general, and administrative			
Employee compensation	$ 13,242	$ 11,379	$ 10,764
Depreciation	1,454	1,755	1,737
PP&E impairment	412	-	-
Intangible asset amortization	523	596	-
Other SG&A [(f)]	5,218	5,141	5,615
Total selling, general, and administrative	$ 20,849	$ 18,871	$ 18,116

(f) Other SG&A consisted primarily of professional services fees, operating lease expense, and the costs paid to third parties for printing, publications, and advertising for the years ended December 31, 20X3, 20X2, and 20X1.

220-40-55-12 In addition to the tabular format disclosure illustrated in paragraph 220-40-55-11, Entity XYZ also must disclose its selling expenses and how it defines selling expenses in accordance with paragraphs 220-40-50-22 through 50-23.

Selling Expenses

During the years ended December 31, 20X3, 20X2, and 20X1, selling expenses were $13,425, $12,123, and $11,585, respectively. The entity's selling expenses include those expenses related to marketing and promotional activities and client relationship management.

• > Example 2: Disaggregation of Income Statement Expenses by an Entity with Service Operations

220-40-55-13 This Example illustrates one type of tabular format disclosure that an entity could use to disclose disaggregated expense amounts in accordance with paragraphs 220-40-50-1 through 50-16. This Example also illustrates the disclosure of selling expenses in accordance with paragraphs 220-40-50-22 through 50-23.

220-40-55-14 For the year ended December 31, 20X3, Entity XYZ, which is a services provider, presents the following comparative statement of operations.

Entity XYZ
Consolidated Statement of Operations
For the Years Ended December 31, 20X3, 20X2, and 20X1

	20X3	20X2	20X1
Revenues	$ 737,132	$ 710,146	$ 694,180
Cost of sales (exclusive of depreciation and amortization shown separately below)	140,055	170,435	145,778
Selling, general, and administrative expenses (exclusive of depreciation and amortization shown separately below)	497,962	458,215	471,626
Research and development expenses (exclusive of depreciation and amortization shown separately below)	57,235	52,174	48,898
Depreciation and amortization	31,578	26,178	23,628
Operating income	10,302	3,144	4,250
Interest expense	3,145	2,665	2,297
Income before income taxes	7,157	479	1,953
Income tax expense	1,503	101	410
Net income	$ 5,654	$ 378	$ 1,543

220-40-55-15 Entity XYZ provides a disclosure that disaggregates the cost of sales; selling, general, and administrative expenses; research and development expenses; and depreciation and amortization captions into the categories listed in paragraph 220-40-50-4. Those expense captions were identified as relevant expense captions because those captions contain one or more of the expense categories listed in paragraph 220-40-50-4. Even though Entity XYZ presents other expense captions on the face of its consolidated statement of operations, such as interest expense and income tax expense, those expense captions do not contain any of the expense categories listed in paragraph 220-40-50-4 (including those described in paragraph 220-40-50-9), so those expense captions do not need to be disaggregated.

220-40-55-16 Entity XYZ also recognizes **one-time employee termination benefits** in cost of sales; selling, general, and administrative expenses; and research and development expenses and, therefore, includes this amount as a separate category in the tabular format disclosure in accordance with paragraph 220-40-50-12. Paragraph 220-40-50-12(e) requires that an entity disclose the amount of each major type of cost associated with an exit or disposal activity (for example, one-time employee termination benefits) that is recognized in each relevant expense caption in the same tabular format in which the disclosures required by paragraph 220-40-50-4 are provided. Because one-time employee termination benefits are a form of employee compensation, Entity XYZ discloses that its employee compensation category excludes one-time employee termination benefits because one-time employee termination benefits are disclosed as a separate category.

220-40-55-17 Entity XYZ recognizes operating lease cost in both cost of sales and selling, general, and administrative expenses. Therefore, in accordance with paragraph 220-40-50-13, Entity XYZ is not required to separately disclose the amounts of cost of sales and selling, general, and administrative expenses that are attributable to operating lease cost. Instead, those expenses are included in the amount for other items for each relevant expense caption in accordance with paragraph 220-40-50-16.

220-40-55-18 Entity XYZ provides the following disclosure.

Disaggregation of Relevant Expense Captions

	20X3	20X2	20X1
Cost of sales			
Cost of sales			
Employee compensation (exclusive of one-time employee termination benefits)	$ 86,336	$ 83,903	$ 100,009
One-time employee termination benefits	7,434	39,298	-
Other cost of sales [(a)]	46,285	47,234	45,769
Total cost of sales	$ 140,055	$ 170,435	$ 145,778

(a) Other cost of sales consisted primarily of operating lease and travel expenses for the years ended December 31, 20X3, 20X2, and 20X1.

	20X3	20X2	20X1
Selling, general, and administrative			
Selling, general, and administrative			
Employee compensation (exclusive of one-time employee termination benefits)	$ 278,859	$ 238,272	$ 301,841
One-time employee termination benefits	19,243	60,635	-
Other SG&A [(b)]	199,860	159,308	169,785
Total selling, general, and administrative	$ 497,962	$ 458,215	$ 471,626

(b) Other SG&A consisted primarily of professional services fees, operating lease expense, and the costs paid to third parties for printing, publications, and advertising for the years ended December 31, 20X3, 20X2, and 20X1.

	20X3	20X2	20X1
Research and development			
Research and development			
Employee compensation (exclusive of one-time employee termination benefits)	$ 46,242	$ 41,379	$ 40,764
One-time employee termination benefits	1,454	1,855	-
Other R&D [(c)]	9,539	8,940	8,134
Total research and development	$ 57,235	$ 52,174	$ 48,898

(c) Other R&D consisted primarily of operating lease expense and payments to third parties for professional services and licenses of intellectual property for the years ended December 31, 20X3, 20X2, and 20X1.

	20X3	20X2	20X1
Depreciation and amortization			
Depreciation and amortization			
Depreciation	$ 19,126	$ 17,984	$ 17,893
Intangible asset amortization	12,452	8,194	5,735
Total depreciation and amortization	$ 31,578	$ 26,178	$ 23,628

220-40-55-19 In addition to the tabular format disclosure illustrated in paragraph 220-40-55-18, Entity XYZ also must disclose its selling expenses and how it defines selling expenses in accordance with paragraphs 220-40-50-22 through 50-23.

Selling Expenses

During the years ended December 31, 20X3, 20X2, and 20X1, selling expenses were $224,536, $223,493, and $231,892, respectively. The entity's selling expenses include those expenses related to advertising and certain customer acquisition-related costs.

• > Example 3: Disaggregation of Income Statement Expenses by a Bank

220-40-55-20 This Example illustrates one type of tabular format disclosure that an entity could use to disclose disaggregated expense amounts in accordance with paragraphs 220-40-50-1 through 50-16. This Example also illustrates the disclosure of selling expenses in accordance with paragraphs 220-40-50-22 through 50-23.

220-40-55-21 For the year ended December 31, 20X3, Entity XYZ, which is a bank, presents the following comparative income statement.

Entity XYZ
Consolidated Income Statement
For the Years Ended December 31, 20X3, 20X2, and 20X1

	20X3	20X2	20X1
Interest income			
Loans	$ 2,795,052	$ 2,142,873	$ 2,072,997
Investment securities	628,887	442,550	465,842
Other	209,629	116,461	79,193
Total interest income	3,633,568	2,701,884	2,618,032
Interest expense			
Deposits	302,797	30,280	151,399
Borrowed funds	279,505	83,852	167,703
Total interest expense	582,302	114,132	319,102
Net interest income	3,051,266	2,587,752	2,298,930
Noninterest income			
Service charges on deposit accounts	201,702	171,062	151,969
Other service charges and fees	282,383	239,487	212,757
Total noninterest income	484,085	410,549	364,726
Total revenue	3,535,351	2,998,301	2,663,656
Provision for (recapture of) credit losses	116,461	(186,337)	372,674
Noninterest expense			
Salaries and employee benefits	1,464,608	1,176,183	1,365,443
Occupancy and depreciation	376,587	279,875	349,679
Data processing	166,111	146,308	161,046
Advertising and marketing	56,876	30,555	28,192
Professional fees	73,230	61,459	74,473
Other	30,513	21,399	24,804
Total noninterest expense	2,167,925	1,715,779	2,003,637
Income before income taxes	1,250,965	1,468,859	287,345
Income tax expense	262,703	308,460	60,342
Net income	$ 988,262	$ 1,160,399	$ 227,003

220-40-55-22 Entity XYZ provides a disclosure that disaggregates the occupancy and depreciation expense and other expense captions into the categories listed in paragraph 220-40-50-4. Those expense captions were identified as relevant expense captions because those captions contain one or more of the expense categories listed in paragraph 220-40-50-4. In this Example, even though Entity XYZ also presents separate expense captions on the face of its consolidated income statement for interest expense, provision for credit losses, data processing, advertising and marketing, professional fees, and income tax expense, those expense captions do not contain any of the expense categories listed in paragraph 220-40-50-4 (including those described in paragraph 220-40-50-9); therefore, those expense captions do not need to be further disaggregated. Entity XYZ applies the practical expedient for employee compensation described in paragraph

220-40-50-11 and elects to not repeat the amount presented on the face of the income statement in the notes to financial statements.

220-40-55-23 Entity XYZ recognizes operating lease cost entirely within occupancy and depreciation expense and, therefore, includes operating lease cost as a separate category in accordance with paragraph 220-40-50-13.

220-40-55-24 Entity XYZ provides the following disclosure.

Disaggregation of Relevant Expense Captions

Occupancy and depreciation expense			
Occupancy and depreciation expense	**20X3**	**20X2**	**20X1**
Depreciation	$ 164,232	$ 146,403	$ 145,907
Operating lease expense	152,445	103,239	149,842
Other occupancy expenses [(a)]	59,910	30,233	53,930
Total occupancy and depreciation expense	$ 376,587	$ 279,875	$ 349,679

(a) Other occupancy expenses consisted primarily of repair and maintenance expense for the years ended December 31, 20X3, 20X2, and 20X1.

Other			
Other			
Intangible asset amortization	$ 13,139	$ 10,980	$ 10,068
Other [(b)]	17,374	10,419	14,736
Total other	$ 30,513	$ 21,399	$ 24,804

(b) Other consisted primarily of regulatory licensing fees and charitable contributions for the years ended December 31, 20X3, 20X2, and 20X1.

220-40-55-25 In addition to the tabular format disclosure illustrated in paragraph 220-40-55-24, Entity XYZ also must disclose its selling expenses and how it defines selling expenses in accordance with paragraphs 220-40-50-22 through 50-23.

> *Selling Expenses*
>
> During the years ended December 31, 20X3, 20X2, and 20X1, the company defined selling expenses to be the same as its advertising and marketing expenses, which are presented on the face of its consolidated income statement. The entity's advertising and marketing expenses include costs incurred for advertising, market research, and business development.

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2023-XX, *Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*

220-40-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2023-XX, *Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*:

Effective date

a. All **public business entities** shall apply the pending content that links to this paragraph for fiscal years beginning after [date to be inserted after exposure] and interim periods within those fiscal years.

Transition method

b. A public business entity shall apply the pending content that links to this paragraph prospectively to financial statements for fiscal years beginning after the effective date and interim periods within fiscal years that begin after the effective date. The disclosures required by the pending content that links to this paragraph need not be included in financial statements for periods beginning before the effective date that are being presented for comparative purposes with financial statements for periods after the effective date.
c. An entity may apply the pending content that links to this paragraph retrospectively to financial statements for periods beginning before the effective date that are being presented for comparative purposes, but if applied to financial statements for periods beginning before the effective date, those disclosures shall be prepared and presented in accordance with this Subtopic.

Amendments to Subtopic 220-10

5. Add paragraph 220-10-05-6, with a link to transition paragraph 220-40-65-1, as follows:

Income Statement—Reporting Comprehensive Income—Overall

Overview and Background

220-10-05-6 Subtopic 220-40 provides guidance on expense disaggregation disclosures and selling expense disclosures.

Amendments to Subtopic 270-10

6. Amend paragraph 270-10-50-7 by adding item q, with a link to transition paragraph 220-40-65-1, as follows:

Interim Reporting—Overall

Disclosure

> Guidance Related to Disclosure of Other Topics at Interim Dates

270-10-50-7 The following may not represent all references to interim disclosure:

q. For income statement expense disaggregation, see Subtopic 220-40.

Disclosure Requirements for Expenses with Existing Mapping Requirements

7. Amend each of the paragraphs listed below (and related pending content) to add the following additional sentence, with a link to transition paragraph 220-40-65-1: "See also the disaggregation disclosure requirements in Subtopic 220-40."

Subtopic	**Paragraph(s) Amended**
326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost	326-20-50-13
326-30, Financial Instruments—Credit Losses—Available-for-Sale Debt Securities	326-30-50-9
330-10, Inventory—Overall	330-10-50-5
340-30, Other Assets and Deferred Costs—Insurance Contracts That Do Not Transfer Insurance Risk	340-30-50-2
340-40, Other Assets and Deferred Costs—Contracts with Customers	340-40-50-3
350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill	350-30-50-1 350-30-50-3
350-40, Intangibles—Goodwill and Other—Internal-Use Software	350-40-50-3

Subtopic	Paragraph(s) Amended
360-10, Property, Plant, and Equipment—Overall	360-10-50-2 360-10-50-3
410-20, Asset Retirement and Environmental Obligations—Asset Retirement Obligations	410-20-50-1
420-10, Exit or Disposal Cost Obligations—Overall	420-10-50-1
450-20, Contingencies—Loss Contingencies	450-20-50-1
460-10, Guarantees—Overall	460-10-50-8
470-20, Debt—Debt with Conversion and Other Options	470-20-50-2C
470-60, Debt—Troubled Debt Restructurings by Debtors	470-60-50-1
606-10, Revenue from Contracts with Customers—Overall	606-10-50-4
805-30, Business Combinations—Goodwill or Gain from Bargain Purchase, Including Consideration Transferred	805-30-50-1
810-10, Consolidation—Overall	810-10-50-1B 810-10-50-3
815-10, Derivatives and Hedging—Overall	815-10-50-4A
830-20, Foreign Currency Matters—Foreign Currency Transactions	830-20-50-1
842-20, Leases—Lessee	842-20-50-4
845-10, Nonmonetary Transactions—Overall	845-10-50-1
920-350, Entertainment—Broadcasters—Intangibles—Goodwill and Other	920-350-50-2 920-350-50-4
926-20, Entertainment—Films—Other Assets—Film Costs	926-20-50-4A 926-20-50-4C

The amendments in this proposed Update were approved for publication by six members of the Financial Accounting Standards Board. Dr. Joseph abstained.

Members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt
Joyce T. Joseph

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. Investors, lenders, creditors, and other allocators of capital (collectively, "investors") have observed that disclosure of disaggregated information about expenses is critically important in understanding an entity's performance, assessing an entity's prospects for future cash flows, and comparing an entity's performance both over time and with that of other entities. Investors have asked for disclosure of the amounts of employee compensation, depreciation, and amortization included in commonly presented expense captions such as cost of sales (including cost of goods sold and cost of services) and SG&A. Investors noted that often there are few expense lines presented on the face of the income statement and that expense items providing differentiated information about an entity's prospects for future cash flows are not presented or disclosed separately. Investors assert that this practice limits their ability to predict an entity's future performance and cash flows.

BC3. Currently, there are no broad requirements in GAAP to disaggregate expenses presented on the face of the income statement. Investors noted that, as a result, there is diversity in the extent to which entities provide disaggregated expense information. Furthermore, the naming and classification conventions for expense captions vary by industry and entity. Therefore, investors have frequently requested that the Board require information about what is included in cost of sales and SG&A to assist them in understanding an entity's cost structure. Investors also have asked for selling expenses to be provided separately from general and administrative expenses.

BC4. The amendments in this proposed Update would require disaggregation of certain expense captions into specified categories in disclosures within the notes to financial statements. This is expected to significantly enhance the transparency of an entity's operations and cost structure and is designed to improve comparability because the specified categories would be more clearly defined than the expense captions presented by many business entities today. For expenses arising from the cost of sold inventory (inventory expense) and manufacturing activities, the proposed amendments would require further disaggregation using a costs incurred approach, which is similar to the approach used by some entities that apply International Financial Reporting Standards Accounting Standards

(IFRS Accounting Standards). This would provide investors with greater visibility into costs that affect an entity’s gross margin and cash flows.

BC5. Finally, the amendments in this proposed Update would require that the amount of selling expenses be disclosed in the notes to financial statements. Investors have indicated that having information about selling expenses separate from other expenses would enhance their ability to predict an entity’s future performance by providing certain insights into costs that are more likely to vary based on changes in revenues. When coupled with the other disaggregation requirements, it also should provide better contextual information for purposes of an entity’s preparation and investors' consideration of MD&A.

Background Information

Existing Requirements

BC6. For business entities, Topic 220 does not contain requirements for the presentation of specific expense captions on the face of the income statement (excluding any SEC Sections). That Topic also does not require any disaggregation of expense captions.

BC7. Presentation of certain income statement expense captions is required by industry-specific guidance or is triggered when a specific event occurs (for example, goodwill impairment for public business entities). Other types of expenses, even when not required to be presented separately on the face of the income statement, are required to be disclosed separately in the notes to financial statements. For certain expenses, GAAP requires that an entity disclose the income statement caption in which the amounts recognized are aggregated, such as for impairment losses on intangible assets within the scope of Subtopic 350-30. In other instances, there is no requirement to disclose the income statement caption in which such expenses are aggregated (such as for advertising expenses within the scope of Subtopic 720-35, Other Expenses—Advertising Costs), even though the amounts may be required to be disclosed in total.

BC8. For public business entities that file or furnish financial statements with or to the SEC (including voluntary filers), general income statement presentation requirements are currently established in SEC Regulation S-X (17 CFR Part 210). Different articles of Regulation S-X apply to entities in different industries. For example, Regulation S-X Rule 5-03, Statements of Comprehensive Income (17 CFR 210.5-03), lists the various expense captions that a commercial and industrial company should present on the face of the statements of comprehensive income, except as otherwise permitted by the Commission, including “costs and expenses applicable to sales and revenues” and “selling, general and administrative expenses.” Entities in other industries, such as banks and bank holding companies, may be required to present different expense captions in accordance with Regulation S-X Rule 9-04, Statements of Comprehensive Income (17 CFR 210.9-04), such as “salaries and employee benefits.”

BC9. Currently, entities that present expense captions such as *cost of sales* or *SG&A* are not required to disaggregate those expense captions into components such as employee compensation, depreciation, and intangible asset amortization.

Project History

BC10. In 2004, the Board and the International Accounting Standards Board (IASB) decided to work jointly on a project on financial statement presentation with the goal of establishing converged guidance.

BC11. In 2008, the Boards issued a Discussion Paper, *Preliminary Views on Financial Statement Presentation*. That Discussion Paper explained that users of financial statements had told the Boards that although disaggregation into functions (such as cost of sales and general and administrative expenses) assists in the analysis of overall business trends (such as in gross margins and operating margins), it aggregates items with different economic drivers (for example, labor and raw materials) and, therefore, reduces the predictive value of the expense information. By contrast, disaggregating expenses by nature would separate expenses that have different economic characteristics. Therefore, the Boards proposed further disaggregating the functional captions by their nature. In comment letters and subsequent outreach, respondents noted that greater disaggregation of expense items would provide decision-useful information. However, some respondents expressed concern that the costs of presenting disaggregated expense items by nature and function would outweigh the benefits.

BC12. A draft for public comment, *Staff Draft of an Exposure Draft on Financial Statement Presentation,* was issued in 2010 jointly by the FASB staff and the IASB staff to serve as the basis for further outreach on the project. The Staff Draft had a broad scope and proposed changes to the requirements for presentation on the income statement, balance sheet, and statement of cash flows. Relevant to the amendments in this proposed Update, the Staff Draft proposed a requirement that an entity disaggregate its expenses by function and then further disaggregate those functional amounts by nature to the extent that the information would be useful in assessing the amount, timing, and uncertainty of future cash flows. Users supported increased disaggregation, while preparers expressed several concerns about the proposal, including the costs associated with generating the information. Upon considering the feedback received, the Board removed the project on financial statement presentation from its technical agenda but continued researching related issues. The IASB suspended its project on financial statement presentation in 2010.

BC13. In 2014, the Board added a research project focused on ways in which financial statement presentation could be improved by leveraging certain aspects of its previous project on financial statement presentation. That research project ultimately focused on financial performance reporting and considered potential improvements through disaggregation and changing the structure of the income statement.

BC14. In 2016, the Board requested feedback through the issuance of the Invitation to Comment, *Agenda Consultation*. That document solicited feedback about the major areas of financial reporting that stakeholders noted should be improved. The 2016 Invitation to Comment specifically highlighted four topical areas for stakeholders' consideration, the financial reporting issues related to each topical area, and some of the possible approaches that the Board could consider in addressing the identified issues. Those topics were identified based on the results of a 2015 Financial Accounting Standards Advisory Council survey that was conducted about the Board's agenda priorities, as well as feedback received from the Board's other advisory groups and other stakeholders. One of the topical areas focused on the reporting of an entity's performance, including the presentation and display of revenues, expenses, gains, and losses reported in the income statement, statement of other comprehensive income, segment disclosures required under Topic 280, Segment Reporting, or in other notes to financial statements.

BC15. Many respondents to the 2016 Invitation to Comment stated that performance reporting was a priority area and supported efforts to provide greater granularity of performance information to show the different sources and characteristics of earnings through either presentation or disclosure in the notes to financial statements. Specifically, they stated that disaggregating performance information should be a priority for the Board's future agenda because it would increase the utility of the income statement in terms of predicting future earnings and cash flows.

BC16. In September 2017, the Board decided to add to its technical agenda a project on the disaggregation of performance information. The Board decided to focus the project on disaggregating certain expenses presented by function into natural components. In 2019, active research on the project was paused to monitor the progress of the Board's project on segment reporting and the IASB's project on primary financial statements.

BC17. In 2021, the Board issued an Invitation to Comment, *Agenda Consultation*. In response, investors and other financial statement users stated that greater disaggregation of financial reporting information—in the income statement, in the statement of cash flows, or in the notes to financial statements—should be a top priority for the Board to help them better perform their analyses. Investors specifically requested more granular information about cost of sales and SG&A because greater granularity and detail of those expense captions would assist investors in understanding an entity's cost structure. Some investors also noted that employee compensation costs should be disclosed, ideally with details by line item.

BC18. In response to the 2021 Invitation to Comment, some preparers indicated that they receive minimal questions on the disaggregation of financial reporting information and cash flows and, therefore, asserted that their investors already receive sufficient information.

BC19. In February 2022, the Board revised the scope and objective of the project in response to the feedback received on the 2021 Invitation to Comment. At that time, the objective was revised to focus on improving the decision usefulness of business entities' income statements.

Basis for Conclusions

Entities Included within the Scope: Public Business Entities

BC20. The amendments in this proposed Update would apply to all public business entities. The proposed amendments would not apply to private companies, not-for-profit entities, and employee benefit plans.

BC21. The Board noted that most of the feedback received about disaggregation on the 2016 and 2021 Invitations to Comment was provided by investors that allocate capital to public business entities. Moreover, most of the feedback received on existing presentation and disclosure practices and the costs to implement various potential disaggregation requirements also focused on public business entities.

Entities Excluded from the Scope: Private Companies

BC22. Some users of private company financial statements indicated that greater expense disaggregation could enhance the decision usefulness of private company income statements. However, the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*, states that because many users of private company financial statements do not seek the same level of detailed information as do users of public company financial statements and because of cost considerations, the Board generally should consider not requiring the disclosure of disaggregated information such as a tabular reconciliation of the beginning and ending balances of balance sheet accounts or quantitative details about the composition of certain income statement or balance sheet line items. For other types of disclosures, the Private Company Decision-Making Framework considers access to management, whether the disclosure can be provided at a reasonable cost, and relevance to the typical financial statement user. Therefore, some Board members expressed that it would be important to better understand whether the ability of private company users, particularly lenders, to access management and request additional information diminishes the need for the disclosures that would be required by the amendments in this proposed Update.

BC23. Considering that public business entity investors and other stakeholders expressed that standard setting in this area is a high priority, the Board concluded that the amendments in this proposed Update should apply only to public business entities. The Board also considered the costs that private company preparers might incur in disclosing disaggregated expense information, noting that most of the research performed to date on the expected costs of disaggregating expenses was drawn from outreach conducted with public business entity preparers. Some Board members stated that they would be open to revisiting, as part of a separate research effort in the future, whether any finalized disaggregation requirements should be considered for private companies after conducting additional research focused on private companies and considering the experience of public business entities that implement any finalized amendments. Members of the Private Company Council (PCC), including members with backgrounds as investors, generally supported the Board's interpretation of the Private Company Decision-Making Framework and its resultant decision to exclude private companies from the scope of the proposed amendments. PCC members also agreed that the Board should consider the experience of public business entities that implement any finalized amendments before potentially revisiting in the future whether and, if so, how those amendments should be extended to private companies.

Entities Excluded from the Scope: Not-for-Profit Entities

BC24. The Board decided to exclude not-for-profit entities from the scope of the amendments in this proposed Update because not-for-profit entities are subject to different expense disclosure requirements that are more disaggregated than those required for business entities. For example, paragraph 958-720-45-15 requires that not-for-profit entities report information about all expenses in one location on the face of the statement of activities, as a schedule in the notes to financial statements, or in a separate financial statement. That paragraph also requires that not-for-profit entities disclose the relationship between functional classification and natural classification for all expenses in an analysis that disaggregates functional expense classifications, such as major classes of program services and supporting activities, by their natural expense classifications, such as salaries, rent, electricity, interest expense, supplies, depreciation, awards and grants to others, and nonemployee professional fees.

Entities Excluded from the Scope: Employee Benefit Plans

BC25. The Board decided to exclude employee benefit plans from the scope of the amendments in this proposed Update because the Board expects that the proposed disclosure requirements would generally not be relevant to users of employee benefit plan financial statements.

Expense Captions Subject to Disaggregation

BC26. The amendments in this proposed Update would require that an entity identify which expense captions presented on the face of the income statement are *relevant expense captions* and then disaggregate the relevant expense captions in a tabular format disclosure in the notes to financial statements.

BC27. For the purposes of the amendments in this proposed Update, an expense caption is relevant if it contains at least one of the following types of expenses: (a) inventory and manufacturing expense, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, or (e) DD&A. The proposed amendments also clarify that because amortization of a finance lease right-of-use asset and amortization of leasehold improvements would be considered a subset of either depreciation or intangible asset amortization, the presence of either expense would cause an expense caption presented on the face of the income statement to be considered a relevant expense caption and, therefore, subject to further disaggregation.

BC28. Many business entities, including public business entities subject to the income statement presentation requirements for commercial and industrial companies currently established by the SEC in Regulation S-X Rule 5-03, Statements of Comprehensive Income, present cost of sales (for example, cost of goods sold, cost of services, or both) and SG&A on the face of the income statement. Other public business entities are not required to present those captions. Some also choose to present other captions (for example, research and development expenses) containing certain types of expenses, such as employee compensation, that are of interest to investors.

BC29. When determining which expense captions should be subject to the proposed disaggregation requirements, the Board decided to focus on the substance of the expenses that are included in a given expense caption rather than the existing presentation guidance that an entity is required to follow, or the title of the caption presented. Therefore, the Board decided to establish requirements that would be flexible and could be applied by public business entities in various industries by proposing that an expense caption would be a relevant expense caption if it contains any of the required expense categories. The Board expects that entities would generally identify cost of sales, SG&A, and research and development expenses (and similarly named expenses) as relevant expense captions when those expense captions are presented on the face of the income statement because of the presence of at least one type of required expense category (such as employee compensation, depreciation, or intangible asset amortization). When presented on the face of an entity's income statement and identified as relevant expense captions, those expense captions would be subject to further disaggregation even though the proposed requirements do not identify specific expense captions by name.

BC30. At various stages during the development of this proposal, the Board considered establishing a scope to focus on cost of sales (including cost of goods sold and cost of services) and SG&A because investors specifically requested greater insight into the components of those two expense captions.

BC31. The Board acknowledges that an advantage of identifying specific expense captions for further disaggregation is that the requirements would target the expense captions that investors had identified most frequently in their feedback. However, the Board was concerned about its ability to define those captions in a manner that would be operable by entities in different industries. For example, the Board considered that some entities present expense captions with varying titles that conform with existing presentation requirements and industry practice. Therefore, the Board was concerned that entities may struggle to identify which captions or combinations of captions would represent cost of sales or SG&A particularly when the expense captions presented do not have standard titles. Furthermore, an approach that focuses only on disaggregation of specific expense captions would leave open the possibility that certain non-specified captions would contain highly aggregated amounts of applicable expenses.

BC32. The Board also determined that investors' need for further expense disaggregation was not necessarily limited to cost of sales and SG&A but that it also existed for other expense captions that, when presented, may include expenses like employee compensation (for example, research and development expenses).

Required Expense Categories

BC33. The amendments in this proposed Update would establish the following required expense categories: (a) inventory and manufacturing expense, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) DD&A. Therefore, an entity would be required to disaggregate relevant expense captions into those required expense categories in a tabular format disclosure in the notes to financial statements.

BC34. The Board's decision to require the disaggregation of relevant expense captions into those specific categories was the product of four key considerations: (a) the required categories are types of natural expenses, (b) a finite number of specified categories would be required (as opposed to a requirement to disaggregate expenses fully by nature), (c) the required categories would align with investors' feedback about the highest priority natural expenses, and (d) it is similar to the current approach taken by the IASB in its project on primary financial statements.

Natural Expenses

BC35. Each required expense category represents what the Board considers to be a natural expense. *Natural expenses*, consistent with their existing definition in the Master Glossary, are distinguishable based on the *types of economic benefits* received in incurring those expenses. Inventory and manufacturing expenses, employee compensation, depreciation, intangible asset amortization, and DD&A each represent expenses for which the economic benefits received by an entity are different. For example, the types of economic benefits received from employees' services are different from the types of benefits received from the use of a building.

BC36. Natural expenses often are contrasted with functional expenses. Functional expenses are distinguishable based on the *purpose* for which the expenses are incurred. While employee compensation may represent one type of natural expense, employee compensation can be divided between different functions, such as manufacturing and production, the cost of providing services, selling, general, and administrative functions, and research and development activities. For example, employee compensation costs incurred to render services to customers and employee compensation costs incurred to conduct research and development activities are incurred for different *purposes* and may be classified within different functional expense captions on the income statement (such as cost of sales and research and development). Determining the purpose for which a cost was incurred is subjective and can require significant judgment. The Board concluded that an allocation of a natural expense to multiple functional expense captions does not affect its underlying natural categorization. For example, allocating the cost of an employee's salary to both cost of sales and research and development does not change the natural classification of the cost incurred. The natural classification of the cost of an employee's salary would still be employee compensation. However, 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. An example would be a commission paid to an employee that is capitalized 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. The amortization of that cost to obtain a contract with a customer would not retain the original natural classification of that expense as employee compensation (see paragraph 220-40-50-13(f)).

BC37. Investors expressed that accurately forecasting individual expense captions requires that they be relatively homogeneous and that the prevailing practice in many industries of combining costs of dissimilar natures within a single functional caption (such as cost of sales) can make forecasting expense captions difficult and prone to error. Some investors stated that disaggregating expenses by nature would increase the predictive value of financial statements because they generally would expect expenses within individual natural expense categories to similarly respond to changes in economic conditions.

BC38. Some investors also expressed that providing expense disclosure categorized by nature could achieve greater comparability between entities than is possible when expenses are categorized by function because the determination of which costs are included in each function (like cost of sales or administrative costs) may depend on how an entity defines that function. Outreach with preparers has indicated that the definitions of internal company functions can differ, even among entities within the same industry.

Specified Required Categories

BC39. The Board has previously considered requiring that business entities disaggregate certain functional expenses fully by nature, similar to the existing requirements for not-for-profit entities. However, business entity preparers have communicated repeatedly that the full disaggregation of functional expenses by nature would be prohibitively costly. Specifically, many preparers explained that their systems are not configured to disaggregate functional expenses by nature and that doing so would require extensive and costly changes to systems, processes, and controls. Furthermore, many preparers noted that providing any disaggregation of functional expenses by nature would be costly because of (a) intra-entity departmental (cost center) allocations, (b) consolidation processes that eliminate intra-entity transactions, (c) acquisitions that require an entity to combine systems that may track expenses differently, (d) the lack of an internal use for expense information disaggregated by nature, and (e) the effect of foreign currency transactions. Additionally, that approach also may require extensive additional guidance on how to classify expenses into natural categories for the purpose of providing the full by-nature disclosure. Preparers' feedback also indicated that the extent of any implementation costs would be influenced by the number of natural expense categories required to be disclosed. Requiring the disaggregation of fewer natural expense categories, while potentially still costly, would be less costly than requiring the full disaggregation of functions by nature.

BC40. The Board determined that the disaggregation of expenses into a predefined and finite number of natural expense categories would achieve a better balance of costs and benefits than the full disaggregation of expenses by nature. That approach also represents more achievable standard setting that can provide investors with tangible benefits on an accelerated timeline when compared with a more protracted approach. Compared with other disaggregation approaches considered in the past, the Board also believes that investors would benefit from enhanced comparability because all public business entities would be required to provide consistent expense categories as defined or described in the amendments in this proposed Update. That is, investors would receive information from all public business entities about inventory and manufacturing expense, employee compensation, depreciation, intangible asset amortization, and DD&A, including the expense captions in which those amounts are included, when applicable. Therefore, the Board decided to identify a finite number of specific required natural expense categories.

Required Categories Based on Investors' Priorities

BC41. The Board considered investors' feedback received as part of its current project and similar past projects to identify the expense categories that entities with diverse cost structures are most likely to incur.

BC42. While certain investors may prioritize expense categories differently, the most requested categories included the costs underlying inventory and manufacturing expenses (for example, costs of materials and labor), employee compensation, depreciation, and intangible asset amortization. For example, one group of analysts noted that it would like to incorporate different rates for commodities, labor, and depreciation when modeling an entity's expenses in future periods. Requiring those categories would isolate two key types of noncash expenses (depreciation and intangible asset amortization) that are sometimes significant components of an entity's functional expenses, allowing investors to better understand the extent to which costs are fixed or variable.

BC43. Given the lack of existing comprehensive disaggregation requirements, it is often not possible to determine what portion of an entity's existing expense captions comprise inventory and manufacturing expenses or employee compensation. However, the Board believes that those expense categories are likely to be among the most significant when considering the expenses of all entities across different industries. That is, the Board chose categories that are expected to be relatively common.

BC44. While the Board acknowledges that DD&A is an industry-specific expense, DD&A was included as a separate required category because it represents a potentially significant noncash expense that is recognized systematically, like depreciation and intangible asset amortization. The Board also reasoned that establishing DD&A as a required category separate from depreciation and intangible asset amortization would clarify the requirements for entities with oil- and gas-producing activities, including those for which the amount of DD&A recognized becomes part of the cost of any oil and gas produced.

Further Disaggregation of Inventory and Manufacturing Expense

BC45. For entities with inventory and manufacturing expense, the amendments in this proposed Update would require further disaggregation of the costs incurred that are either capitalized to inventory or expensed as incurred during the current period. The cost categories required for the further disaggregation of inventory and manufacturing expense would be (a) purchases of inventory, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) DD&A. For this disaggregation requirement, employee compensation should include both direct and indirect employee labor costs to the extent that they relate to manufacturing activities.

BC46. Investors have consistently asked for greater visibility into the types of costs included in cost of goods sold and similar expense captions. Often, investors have specifically requested information about natural costs such as the cost of labor and materials. Investors also expressed that currently they do not receive sufficient information from entities about the nature of costs in cost of goods sold in the notes to financial statements or in MD&A. For example, investors indicated that entities often provide only qualitative descriptions of how changes in natural costs have affected gross margins during a given period but seldom provide a quantitative disaggregation of cost of goods sold.

BC47. By contrast, preparers stated that the disaggregation of inventory expense into specific natural categories (such as employee compensation, depreciation, and materials) would be prohibitively costly because it would require the retrospective identification of costs capitalized as part of inventory sold in the current period, which potentially includes costs capitalized in prior periods. Many preparers explained that identifying the actual costs capitalized to a given unit of inventory that is sold in the current reporting period would not be cost-effective and may not be feasible. Preparers cited the use of standard costs, cost flow assumptions, and the aggregation of various natural costs when computing variances as being among the significant complications to any effort to disaggregate inventory expense further by nature. Additionally, in cases in which the costs of inventory were capitalized many years ago (for example, during a last-in, first-out liquidation), preparers indicated that further disaggregation would be particularly problematic.

BC48. The Board also observed that, in order to apply existing inventory accounting requirements, manufacturing entities need to have systems designed to appropriately track and/or approximate costs incurred in the production process. The Board observed that manufacturing entities that apply IFRS Accounting Standards and present their expenses using the nature of expense method in accordance with IAS 1, *Presentation of Financial Statements*, sometimes separately provide major natural cost categories that combine expenses and costs capitalized to inventory during the reporting period. The Board acknowledges that those costs often are not disaggregated by function and may also include costs capitalized to assets other than inventory. Also, the Board observed that when entities applying IFRS Accounting Standards present costs such as “employee costs” or “purchase of inventories,” those entities also present a “changes in inventories” caption (or similar caption) to reconcile costs incurred to expenses recognized during the period.

BC49. Therefore, the Board expects that it would be feasible for entities, including manufacturing entities, to disaggregate costs incurred that are either capitalized to inventory or expensed as part of manufacturing activities during the *current period*, with accompanying disclosure of captions for (a) changes in inventories, which, for example, could include an adjustment to inventories resulting from an impairment charge related to inventories capitalized in a prior period, and (b) other adjustments and reconciling items to reconcile the amount of costs incurred to the amount of expenses recognized. Any amount of inventory derecognized during the period that does not meet the definition of *inventory expense* and any amounts attributable to differences in foreign currency exchange rates used to translate costs incurred and the beginning and ending balances of inventory are examples of amounts that would be included in the disclosure of other adjustments and reconciling items.

BC50. The Board emphasizes that the amendments in this proposed Update would not require that an entity disaggregate the nature of costs previously capitalized to units of inventory that were sold during the current period. Instead, the amounts required by the proposed amendments would represent *costs incurred in the current period*. As a result, the Board believes that the approach that would be required by the proposed amendments would be similar to the approach applied by entities under IFRS Accounting Standards and would not be similar to requiring entities to disaggregate the costs of inventory units sold in the current period.

BC51. Investors generally noted that information disaggregated in this manner would be decision useful, particularly compared with what is provided today. The Board acknowledges that in periods in which production and sales levels are significantly different, using costs capitalized in the current period may not be as intuitive as in periods in which production and sales levels are more closely aligned. However, the Board believes that this approach is the most practicable and cost-effective method for disaggregating inventory costs and investors would be able to look to an entity's inventory turnover to better understand trends and periods of volatility.

BC52. Ultimately, the Board expects that investors would benefit significantly from the improved transparency of inventory and manufacturing expense, which the Board understands is frequently among the most significant expenses for entities in many industries.

BC53. The Board acknowledges that this method would be costlier to apply than if no further disaggregation of inventory and manufacturing expense was required. The Board understands that challenges related to the use of standard costs, intra-entity allocations, foreign currency transactions, and consolidations are likely to influence the cost of implementing the amendments in this proposed Update. However, to reduce implementation challenges, the proposed amendments would require that an entity combine costs capitalized to inventory with manufacturing expenses recognized (if any).

BC54. While the Board acknowledges that this approach would require that inventory and manufacturing expenses be separated from nonmanufacturing expenses (which is a functional classification), it believes that this approach would reduce implementation challenges for manufacturing entities. In particular, the Board expects that this approach would be less costly than an approach that would require that an entity separate costs (like depreciation or employee compensation) capitalized to inventory from those that are expensed as incurred but relate to the same manufacturing process as the costs that were capitalized to inventory. The Board understands that manufacturing entities may combine and then allocate directly to cost of goods sold certain manufacturing costs that are potentially capitalizable depending on inventory turnover rates and production levels. Therefore, the Board decided not to require that manufacturing entities separate those costs when they are included in the same cost pool as amounts that are capitalized to inventory (even if some costs included in that cost pool are expensed as incurred).

Purchases of Inventory

BC55. The amendments in this proposed Update would require the disaggregation of costs incurred that are either capitalized to inventory or expensed in manufacturing activities during the current period into categories, including purchases of inventory. The Board decided that purchases of inventory would be a useful category for investors that analyze the performance of entities with significant inventory balances. For manufacturing entities, the Board expects purchases of inventory to be useful as a standalone category containing the amount of costs incurred in the current reporting period to acquire raw materials and other externally purchased inputs because it would enable investors to combine the cost amounts disclosed with information from other sources (for example, the prevailing market prices of known key inputs) to assess the effect on an entity's performance. In addition, this disclosure would assist investors in understanding the relative cost of purchased inventory (including purchases of materials) and employee compensation to a manufacturing entity. The Board understands that, in some industries, purchases of inventory can constitute most of an entity's inventory cost. Therefore, the Board expects that the required disclosure of both purchases of inventory and employee compensation would help an investor understand an entity's relative cost exposures.

BC56. The Board considered requiring raw materials consumed or purchased as a separate required category (that is, provided separately from purchases of finished goods inventory). Similar categories are sometimes provided by international entities that present expenses by nature. However, the Board decided that requiring raw materials consumed or purchased as a separate category would be impracticable for many entities for which it is difficult to meaningfully distinguish between raw materials, work-in-process, and finished goods inventories. The Board also noted that the purchase of a product may be a finished good for one entity and a raw material component for another entity. Moreover, some preparers expressed that it would be challenging to provide this category when there are significant intra-entity transactions that are required to be eliminated in consolidation. Therefore, the Board decided to require that an entity provide purchases of inventory, which includes purchases of raw materials.

Required Category Definitions

BC57. The amendments in this proposed Update would establish new Master Glossary definitions for the terms *employee, employee compensation, inventory and manufacturing expense,* and *inventory expense*. Depreciation, intangible asset amortization, and DD&A would not be defined in the Master Glossary and, instead, would reference existing disclosure requirements or other existing areas of guidance.

Employee and Employee Compensation

BC58. The amendments in this proposed Update would define the term *employee compensation* based on the existing definition of the term *employee* in Topic 718 and use a definition of *compensation* that is intended to broadly capture the major types of consideration granted or issued to employees in exchange for services.

BC59. The Board determined that using an existing definition of the term *employee* would improve the operability of the amendments in this proposed Update, would promote consistency in application across entities, and would avoid creating additional conflicting definitions of the same term within GAAP. The Board noted that the definition of the term *employee* currently in Topic 718 refers specifically to stock compensation rather than employee compensation broadly. Therefore, the Board decided to amend the definition of the term *employee* in Topic 718 to incorporate minor conforming changes that consider forms of consideration other than stock compensation. The Board expects that applying the amended definition of *employee* would be no different from applying the existing definition of *employee* in the context of stock compensation. The Board expects that the changes made to the term *employee* would not affect how that term is currently interpreted for the purpose of applying the guidance in Topic 718.

BC60. The Board also decided that the term *compensation* should be defined to include common significant types of noncash compensation such as share-based payments. The Board determined that it was important to provide a definition so that an entity would not be required to make complex determinations about whether typically minor, but common, types of noncash employee benefits (such as subsidized goods and services) represent employee compensation or a different type of natural cost. The Board established the definition of *compensation* as a minimum requirement, which would permit but not require any entity that provides certain types of noncash compensation (such as subsidized goods or services) to classify those amounts as *employee compensation*.

BC61. The Board also determined that investors would benefit if the term *compensation* broadly aligned with the IFRS Accounting Standards' definition of the term *employee benefits* in IAS 19, *Employee Benefits*, which includes all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment, including wages, salaries, social security contributions, other short-term employee benefits, postemployment benefits, other long-term employee benefits, and termination benefits.

BC62. The Board decided that because entities complying with SEC Regulation S-X Rule 9-04 are generally required to present a caption for salaries and employee benefits, those entities should have a practical expedient for determining what amounts are classified as employee compensation. That is, an entity that presents salaries and employee benefits in accordance with Rule 9-04 need not apply the definition of *employee compensation* in the proposed amendments. The Board does not expect that those entities would have disclosed substantially different amounts for employee compensation under the definition in the amendments in this proposed Update.

Inventory and Manufacturing Expense

BC63. The Board observed that the cost of sold inventory is sometimes referred to as "cost of goods sold," while many entities also present an expense caption titled "cost of sales" or "cost of products sold." However, the Board understands that "cost of sales" or "cost of products sold" as typically presented on an entity's income statement may include, in addition to the cost of sold inventory, period expenses that are not capitalized to inventory (for example, warranty expenses and fulfillment costs such as shipping and handling). Therefore, in practice, a "cost of sales" caption presented on the face of the income statement may contain all costs associated with revenues, rather than only the cost of sold inventory.

BC64. To avoid confusion between the amounts recognized as an expense for the cost of sold inventory and the common name of expense captions presented on the face of the income statement (cost of sales), the Board decided to define the term *inventory expense* as an expense resulting from the derecognition of inventory related to sales to customers, consumption in the process of such sale, or remeasurement (for example, an impairment). The term *inventory expense* only refers to expenses; therefore, only amounts recognized as an *expense* (rather than another income statement element) would satisfy the definition. This definition incorporates the existing definition of the term *inventory* in Topic 330, Inventory*.* The term *inventory expense* would be a subset of the required category *inventory and manufacturing expense*, which also would be defined separately in the Master Glossary. The term *inventory and manufacturing expense* includes both inventory expense and other manufacturing costs that are expensed as incurred. The proposed amendments would require that an entity disclose how it defines other manufacturing expenses.

BC65. The Board notes that the amendments in this proposed Update are focused on disaggregation of expenses and would not require the disaggregation of gains and losses. Therefore, the Board also decided to clarify that inventory expense should include only amounts that are generally expensed and not amounts embedded in a gain or loss. The Board acknowledges that the cost of sold inventory could be embedded in a gain or loss, for example, when derecognized as part of the transfer of a business. Therefore, the Board decided that inventory expense should include only the cost of inventory either sold to customers or remeasured in accordance with Section 330-10-35, Inventory—Overall—Subsequent Measurement, or any other Industry Subtopic within Topic 330.

References to Existing Standards for Other Required Categories

BC66. The Board decided to reference existing requirements for each of the other required expense categories: depreciation, intangible asset amortization, and DD&A. For example, the description of depreciation references the requirement in Subtopic 360-10 to disclose "depreciation expense for the period," and the description of intangible asset amortization references the requirement in Subtopic 350-30 to disclose "the aggregate amortization expense for the period." The Board also determined that entities would be able to identify purchases of inventory provided that the definition of the term *inventory* is consistent with its existing definition in Topic 330.

BC67. For certain expenses that are described as "amortization" in accordance with existing GAAP, the Board expects that entities would be able to determine the appropriate categorization as depreciation, intangible asset amortization, DD&A, or none of those categories without additional guidance. For example, the Board believes that the existing guidance is clear that capitalized costs of software to be sold, leased, or marketed are subject to the disclosure requirements in Subtopic 350-30 and, therefore, amortization of those capitalized software costs would be considered intangible asset amortization for the purposes of applying the amendments in this proposed Update.

BC68. The Board acknowledges that diversity in practice may exist with respect to whether certain items are determined to be depreciation or intangible asset amortization. However, the Board determined that revising long-standing disclosure requirements for these amounts would add significantly to the time required to develop guidance in this project, could disrupt existing practice, and would not necessarily provide a benefit for investors.

BC69. The Board also is aware of diversity in practice with respect to the classification of the amortization of internal-use software within the scope of Subtopic 350-40, Intangibles—Goodwill and Other—Internal-Use Software, the amortization of a lessee's finance lease right-of-use assets recognized in accordance with paragraphs 842-20-35-7 through 35-8, and the amortization of leasehold improvements recognized in accordance with paragraphs 842-20-35-12 through 35-13.

BC70. The Board decided that additional guidance for internal-use software would be unnecessary given the references in paragraph 350-40-50-1 to the disclosure requirements for property, plant, and equipment in Subtopic 360-10. The Board expects that entities would conclude that the amortization of internal-use software should be reflected in the disclosures required by the amendments in this proposed Update as either depreciation recognized in accordance with Subtopic 360-10 or intangible asset amortization recognized in accordance with Subtopic 350-30.

BC71. The Board decided that, by contrast, additional specific guidance should be added for the amortization of a lessee's finance lease right-of-use assets recognized in accordance with paragraphs 842-20-35-7 through 35-8 and the amortization of leasehold improvements recognized in accordance with paragraphs 842-20-35-12 through 35-13. While the Board acknowledges that the existing guidance in Topic 842, Leases, does not prescribe whether those types of amortization should be included as part of existing disclosure requirements for depreciation or intangible asset amortization, the Board decided to explicitly require in the amendments in this proposed Update that those amounts be included in either depreciation or intangible asset amortization. The Board expects that this would not disrupt practice and would ensure that entities do not omit amortization of finance lease right-of-use assets or amortization of leasehold improvements from the disclosures required by the proposed amendments. Depending on the extent to which depreciation or intangible asset amortization is capitalized to assets other than inventory, the Board acknowledges that the total amounts of depreciation and intangible asset amortization disclosed in accordance with paragraph 220-40-50-4 may not be equal to total depreciation and intangible asset amortization disclosed in each respective footnote in accordance with Subtopics 360-10 and 350-30.

Integration of Existing Disclosure Requirements

BC72. The amendments in this proposed Update would require that an entity incorporate certain existing disclosures when disaggregating the relevant expense captions in a tabular format disclosure. Specifically, the proposed amendments would require that an entity include certain disclosures for which there is an existing requirement to disclose the amount and the caption in the income statement to which the amount is recorded. For example, the guidance in Subtopic 926-20, Entertainment—Films—Other Assets—Film Costs, requires that an entity disclose the amount of amortization of film costs and the caption in the income statement where the amortization is recorded. Therefore, if the amortization of film costs is included in a relevant expense caption, it would be required to be incorporated into the tabular format disclosure. The Board selected the existing disclosure requirements on the basis of whether the amount disclosed would be a type of expense, gain, or loss that would be mutually exclusive from the required categories.

BC73. The amendments in this proposed Update also would require that an entity incorporate other existing disclosures into the tabular format disclosure. Specifically, the tabular format disclosure would include certain amounts that are (a) already required to be disclosed, (b) not subject to an existing requirement to disclose the caption(s) in the income statement to which the amount is recorded, and (c) entirely recognized in one expense caption that is also a relevant expense caption determined in accordance with the guidance in paragraph 220-40-50-10. For example, the amounts of amortization of costs to fulfill a contract with a customer and warranty accruals are required to be disclosed under existing GAAP, but there is no existing requirement to disclose the caption in the income statement to which those expenses are recorded. Therefore, if the amortization of costs to fulfill a contract with a customer and warranty expenses were classified entirely in cost of goods sold, and cost of goods sold was determined to be a relevant expense caption, then an entity would be required to include the amortization of costs to fulfill a contract with a customer and warranty expenses in the tabular format disclosure that disaggregates cost of goods sold. 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. When making that decision, the Board considered feedback on the cost of quantifying the amounts of expenses included in captions on the income statement when those expenses are allocated to multiple captions.

BC74. When developing the list in paragraph 220-40-50-13, the Board excluded functional expenses (such as research and development expenses) and items that might overlap with the required categories. By contrast, an expense that is accrued when the conditions in paragraph 450-20-25-2 are met, for example, product warranties, would not overlap with the required categories, even if the accrued obligation is expected to be satisfied by incurring costs that would be included within the required categories such as employee compensation.

BC75. For each of the proposed requirements, the Board determined that incorporating existing disclosure requirements into the tabular format disclosure would assist investors in locating relevant information and would likely not result in significant incremental costs for preparers.

BC76. Moreover, the Board believes that incorporating those disclosures will enhance the relevance of the tabular format disclosure by reducing the amounts disclosed for categories that are labeled as "other."

BC77. If an entity has previously concluded that a disclosure in the lists in paragraph 220-40-50-12 or 220-40-50-13 is not required (for example, because of the application of the guidance in paragraph 105-10-05-6, which states that "the provisions of the Codification need not be applied to immaterial items" or because the amount is not required to be disclosed in interim financial statements), the Board expects that the amendments in this proposed Update would not affect that conclusion.

Qualitative Description of Other Items and Costs

BC78. The amendments in this proposed Update would require that an entity qualitatively describe the nature of the expenses included in a relevant expense caption that are not required to be quantitatively disaggregated.

BC79. The amendments in this proposed Update also would require that an entity qualitatively describe the nature of manufacturing costs incurred that are either capitalized to inventory or expensed in the current period (as well as any other items needed to reconcile costs incurred to expenses recognized) if those costs do not fall within the required categories. For entities without manufacturing activities, the proposed amendments would require a description of other costs capitalized to inventory during the period.

BC80. The Board anticipates that investors would benefit from additional qualitative descriptions of any amounts that remain after the quantitative disaggregation requirements are applied to expenses recognized and manufacturing costs incurred that are either capitalized to inventory or expensed in the current period (for example, the amounts remaining in "other cost of sales" or "other costs capitalized to inventory and other manufacturing expenses").

BC81. Although investor outreach performed to date has indicated a preference for quantitative disaggregation, some investors stated that if quantitative disclosure of certain expenses was not required, a qualitative description of the remaining amounts of those expenses would provide additional context, especially if there are significant changes in the nature of costs incurred or expenses recognized. The detail provided in those qualitative disclosures should be commensurate with the significance of the amounts being described.

BC82. The Board considered that most preparers have demonstrated in outreach or in existing public filings that they are able to describe the nature of their most significant costs, even if they are not readily able to quantify the amount of those costs within each caption presented on the face of the income statement. Therefore, the Board anticipates that a qualitative description would provide investors with additional relevant expense information and would not involve significant implementation costs for preparers.

Considered but Dismissed: Additional Quantitative Disaggregation Threshold or Principle

BC83. The Board considered, but dismissed, an alternative that would have utilized a quantitative threshold to require further disaggregation of expenses and costs. The Board observed that this approach would ensure that entities provide a minimum level of disaggregation.

BC84. The Board was concerned, however, that a quantitative threshold would result in costs to preparers similar to providing a full disaggregation of functional expenses by nature. Some members of the Board questioned whether this would diminish the practicality of prescribing specific required expense categories.

BC85. Considering the other quantitative disaggregation requirements included in the amendments in this proposed Update, the Board determined that a qualitative description of the amount remaining in each relevant expense caption would better balance the benefits and costs than requiring additional quantitative disaggregation based on a threshold or principle. The Board reached the same conclusion when considering whether to require further quantitative disaggregation of the amount of inventory and manufacturing expense.

Selling Expenses

BC86. The amendments in this proposed Update would require that an entity disclose selling expenses as well as how it defines selling expenses. Unless selling expenses is a relevant expense caption because an entity presents it as a separate caption on the face of the income statement, an entity would not be required to further disaggregate the disclosed amount of selling expenses into the required expense categories. Moreover, the Board intended selling expenses to include only items that are presented as *expenses* in the income statement.

BC87. The Board decided to require this disclosure in response to feedback indicating that investors would benefit from separate disclosure of selling expenses, which many entities combine in a caption with general and administrative expenses. For example, some investors indicated that they would prefer to forecast selling expenses separately from general and administrative expenses.

BC88. Although the Board considered requiring the disaggregation of SG&A, specifically to separate selling expenses from general and administrative expenses, it noted that there is significant diversity in the presentation practices of public business entities. For example, some entities present multiple expense captions that are components of SG&A on the face of the income statement, while other public business entities do not present SG&A on the face of the income statement. Therefore, the Board decided to require disclosure of selling expenses in a manner that is similar to what is currently required for research and development expenses and advertising expenses. However, because (a) research and development and advertising expenses are defined in GAAP and (b) the Board chose not to define *selling expenses* in the amendments in this proposed Update, the Board also decided to require an additional qualitative disclosure about an entity's definition of *selling expenses.*

BC89. Because the amendments in this proposed Update would not define the term *selling expenses,* the Board expects that entities would arrive at conclusions about which expenses to classify as part of their selling function that are specific to their facts and circumstances and their own tailored definition of *selling*. The Board observed that some entities already present expense captions on the face of their income statement with titles such as "sales and marketing" or "advertising and marketing" separately from general and administrative expenses even though GAAP does not define *selling expenses* or *general and administrative expenses*. Therefore, the Board expects that entities that do not already present a similar caption would be able to determine which expenses they consider to be selling expenses consistent with the practice of entities that already provide this information voluntarily. The Board also observed that management would have broad latitude in defining *selling expenses,* including whether selling expenses include or exclude fulfillment costs, costs associated with physical sales locations, websites, allocation of management expenses, and many other acceptable judgments as made by preparers.

Disclosure Rather Than Presentation Requirements

BC90. The amendments in this proposed Update would not establish any new income statement presentation requirements. All the proposed disaggregation requirements would take the form of required disclosures. When considering whether to establish new presentation requirements, the Board observed that the disaggregation requirements for some entities could result in an overly detailed income statement and would disrupt existing presentation practices, some of which are established by the SEC, rather than the Board.

Interim Reporting

BC91. The amendments in this proposed Update would require that the expense disaggregation disclosures and the quantitative disclosures for selling expenses be provided in both annual and interim reporting periods. The Board emphasized the importance of providing investors with timely information about certain expense and cost categories that would be required under the proposed amendments. The Board understands that investors monitor entities throughout their respective fiscal years and update expectations (including quantitative models) for an entity's major individual expense captions throughout the year, rather than only when annual financial statements are issued. Therefore, rather than requiring the disaggregation disclosures for only annual periods, the Board expects that the benefits provided to investors would be greater if the expense disclosures were required for both annual and interim reporting periods.

BC92. The Board acknowledged that Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 8, Notes to Financial Statements,* states that "interim-period financial statements are essentially an update of the information in the most recent annual statements . . ." (paragraph D73) and "generally are aggregated to a greater degree than a full set of annual financial statements" (paragraph D75). However, the Board noted that investors would prefer receiving disaggregated expense information at both annual and interim reporting periods. Moreover, the Board noted that although the amendments in this proposed Update would not establish new income statement presentation requirements, it viewed the disaggregation disclosures as similar to an extension of an entity's income statement presentation. Therefore, the Board decided that a similar degree of detail about expenses should be provided in both annual and interim reporting periods.

BC93. The Board also considered challenges unique to providing disaggregated expense information during interim reporting periods. Specifically, Board members noted that existing requirements for interim reporting established by the SEC generally provide entities with less time to prepare interim financial statements than is provided for annual financial statements. The Board also considered the effect on ongoing costs attributable to requiring disaggregated expense information more frequently. While the Board acknowledges that requiring entities to apply the amendments in this proposed Update at both annual and interim reporting periods would be more costly than requiring that the proposed amendments be applied at annual reporting periods only, it expects that entities would be able to develop systems and processes that reflect the proposed amendments and could accommodate the condensed time frame for producing interim financial statements.

BC94. The Board also considered that entities complying with SEC Regulation S-X may present a condensed income statement for interim reporting purposes. If an entity provides condensed financial statements and therefore changes the expense captions presented on the face of its income statement, the Board observed that the relevant expense captions could be different at interim and annual reporting periods. Under the amendments in this proposed Update, the relevant expense captions would be determined by evaluating the expense captions that are presented on the face of the income statement and whether those expense captions include required expense categories. Therefore, the disaggregation requirements would apply to the captions presented in a given reporting period.

Other Disaggregation Approaches Considered but Dismissed

BC95. Since the project on disaggregation of income statement expenses was added to the Board's technical agenda in 2017, the Board has considered several other disaggregation approaches.

Nature and Function

BC96. When the project was originally added to the Board's agenda, the Board considered whether to require disaggregation of functional expense captions, such as cost of sales and SG&A, into their natural components (for example, compensation, utilities, and rent). While feedback from investors indicated that this type of disaggregation would yield decision-useful information, preparers expressed concerns that a requirement to fully disaggregate functional expenses by nature would be very costly and potentially impracticable for cost of goods sold.

Internal View

BC97. In response to preparers' feedback, the Board considered an expense disaggregation approach that would have leveraged how consolidated expenses are viewed internally by management (a concept not dissimilar to the management approach in segment reporting). The internal view approach would have aimed at helping investors understand an entity's performance and assess its prospects for future cash flows using information that is better aligned with management's perspective. To understand the types of information that would have been provided under the internal view approach, the Board conducted outreach with preparers.

BC98. During outreach, the Board observed that the extent of the disaggregated consolidated expense information reviewed by management and the purpose for which it uses that information to make decisions varied significantly between entities. This was evidenced during outreach by some preparers identifying an internal view of disaggregation that did not differ in any meaningful way from the view that is already presented to external users in their financial statements or in MD&A. This was particularly true for the cost of sales caption, which few participants would have disaggregated in any meaningful way on a consolidated basis under their internal views.

BC99. Moreover, outreach participants expressed concern that the information provided by management's internal view might not be reconcilable to the consolidated financial statements in a cost-efficient manner because of the use of non-GAAP information and the effect of allocations on income statement expense captions.

BC100. The Board also was concerned that the internal view approach might not enhance comparability between entities and that changes in the internal view over time might prevent meaningful trend analysis.

BC101. After the Board discussed the feedback on the internal view in a public Board meeting in 2019, it decided to pause active research on this project to monitor the progress of its project on segment reporting and the IASB's project on primary financial statements. During the deliberations of both this project and the segment reporting project, some stakeholders suggested that the two projects should use the same disaggregation approach. Feedback received on the segment reporting project indicated that stakeholders generally supported the management approach in determining the disclosure of significant segment expenses. However, the Board decided not to pursue the same approach in both projects because of the challenges previously identified with the internal view approach in this project.

Disaggregation Principle

BC102. When the Board restarted research on the project on expense disaggregation in 2022, it initially sought to leverage a disaggregation principle for cost of sales and SG&A that would have been similar to the existing disaggregation requirement for revenue from contracts with customers.

BC103. Some preparers provided feedback indicating that they would struggle to apply an expense disaggregation principle that was similar to the revenue disaggregation principle without extensive implementation guidance and examples. Preparers also explained that a principle that was not based on management's view of the business would be challenging to understand given the existing requirements for segment reporting disclosures.

BC104. Concurrently, some investors expressed concern that the disaggregated information provided under a principle would not enhance comparability. Some Board members noted that preparers might interpret any disaggregation principle using language similar to the existing disaggregation principle in Topic 606, Revenue from Contracts with Customers, to be a de facto requirement to disaggregate cost of sales and SG&A by nature. Other Board members noted that defining expense captions such as cost of sales and SG&A would be challenging and that any resulting definitions would be difficult to apply across different industries. Therefore, those Board members were concerned that it would be unclear which expense captions were subject to any disaggregation requirements and decided to develop guidance that more specifically prescribes the information required to be disclosed.

Costs Incurred in Total

BC105. The amendments in this proposed Update would require that an entity provide more information about costs incurred that are either (a) expensed as incurred or (b) capitalized to inventory than is currently required. However, some stakeholders and Board members expressed that for certain types of natural costs such as employee compensation, it would be decision useful to require the disclosure of total costs incurred. For example, some investors in response to the 2021 Invitation to Comment, *Agenda Consultation*, noted that disclosure of employee compensation in total and in greater detail would be beneficial.

BC106. While some investors specifically asked for employee compensation costs in total, several Board members observed that some of those costs would not necessarily relate to the disaggregation of *expenses*. For example, employee compensation costs that are direct loan origination costs are required to be deferred and recognized as a reduction in the yield of the loan, rather than as an expense. Therefore, those Board members concluded that those amounts did not relate to the objective of expense disaggregation.

BC107. Although costs that are capitalized to inventory are also not expensed when incurred, the Board determined that this type of cost disaggregation was the only practicable method for providing investors with additional visibility into the cost of inventory recognized as an expense when sold, consumed, or remeasured. Therefore, the Board viewed this type of cost disclosure as directly relevant to the objective of disaggregating expenses included in cost of goods sold. Similarly, although employee costs capitalized to assets such as software or costs to obtain or fulfill a contract with a customer may eventually be recognized as an expense (through subsequent amortization or impairments), the Board decided that a requirement to disclose the amount of any employee costs capitalized to those other assets was outside the project's current scope.

Comparison with IFRS Accounting Standards

BC108. Currently, IAS 1 requires that an entity that classifies expenses by function disclose additional information about the nature of expenses, including total depreciation, amortization, and employee benefits expenses. However, IAS 1 does not require that an entity disclose the amounts of those natural expenses that are included in each line on the statement of profit and loss. In 2014, the IASB added a project on primary financial statements to its research agenda and in 2016 decided on a project scope mainly focused on targeted improvements to the statement of profit and loss. In 2019, the IASB issued an Exposure Draft, *General Presentation and Disclosures*.

BC109. Concurrent with the Board's initial deliberations on this project, the IASB redeliberated proposals issued as part of its project on primary financial statements. While the IASB project's scope is broader than the scope of the Board's project on expense disaggregation, both projects have considered disaggregating functional expenses into certain natural categories or vice versa. As of the date that the Board completed major deliberations of the amendments in this proposed Update, the IASB had tentatively decided to change the specific disclosure requirement for operating expenses by nature proposed in its Exposure Draft to require that an entity disclose the amounts of depreciation, amortization, employee benefits, impairments, and write-downs of inventory included in each functional line item in the statement of profit or loss in a single note within the notes to financial statements. The IASB also tentatively decided to provide guidance clarifying that the amounts of depreciation, amortization, employee benefits, impairments, and write-downs of inventory are not required to be expense amounts and to require that an entity provide a qualitative explanation if part of the amount disclosed has been included in the carrying amount of assets. The explanation would include identifying the assets in which the amounts have been included.

BC110. The amendments in this proposed Update are similar to the approach tentatively decided upon by the IASB in that investors would be provided with information about how certain natural expenses (depreciation, intangible asset amortization, and employee compensation) are allocated to different functional expense captions on the face of the income statement. The Board expects that investors would benefit from increased comparability if these similar requirements were finalized.

Interaction with Segment Reporting Disclosure Requirements

BC111. The Board acknowledges that both the amendments to Topic 280's segment disclosure requirements in the proposed Accounting Standards Update, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures,* dated October 6, 2022, and the amendments in this proposed Update would require additional expense disclosures. However, the method for determining what expense information must be disclosed under the two proposals differs. In addition to the existing expense disclosure requirements in Topic 280, the amendments in the proposed Update on segment reporting would require disclosure of significant segment expenses that are both regularly provided to the chief operating decision maker and included within each reported measure of segment profit or loss.

BC112. For segment reporting, the method for determining what disaggregated information to report is referred to as the management approach. The management approach is based on the way that management organizes the segments for making operating decisions and assessing performance.

BC113. By contrast, the amendments in this proposed Update do not utilize a management approach for further disaggregation of expenses. The Board notes that the types of expense information provided under Topic 280 could be different from the information that would be required under the amendments in this proposed Update. The Board believes that both types of disaggregation, even when different from each other, would be useful to investors.

BC114. The Board also acknowledges that whether management has an internal use for certain types of disaggregated expenses remains a consideration in this project. Specifically, whether information is used internally by management was considered by the Board when assessing the potential costs to implement the amendments in this proposed Update. However, the Board also acknowledges that the information used internally by management for making operating decisions and assessing performance might differ from the information used by investors in forecasting future cash flows and making resource allocation decisions. Furthermore, costs to preparers are considered by the Board in relation to the benefits to investors, rather than in isolation.

Transition and Effective Date

BC115. The Board decided that an entity should be required to apply the amendments in this proposed Update prospectively but that the entity would be permitted to apply the amendments retrospectively. The Board believes that many entities may not have all of the prior year information necessary to apply the amendments retrospectively. Consequently, the Board determined that requiring retrospective transition could be costly and would necessitate a later effective date than would be feasible if the proposed amendments could be applied prospectively. However, some Board members believe that entities may prefer to provide the disclosures for comparative periods upon adoption, even if the proposed amendments permit prospective application of the guidance.

BC116. The Board will determine the effective date and whether early application should be permitted after it considers stakeholders' feedback on the amendments in this proposed Update.

Benefits and Costs

BC117. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC118. For the amendments in this proposed Update, the Board expects that the key benefits would be as follows:

a. Disclosing inventory and manufacturing expense, employee compensation, depreciation, intangible asset amortization, and DD&A that are expensed as incurred would provide transparency about the components of expense captions and would enhance investors' ability to forecast future performance because those expense categories are expected to respond differently to changes in economic conditions. Requiring those categories also is expected to improve comparability because the composition of expenses included in the categories is more consistent than that of expense captions such as cost of sales or SG&A.

b. Disclosing costs incurred that are capitalized to inventory or expensed as part of manufacturing activities in the current period, including purchases of inventory, employee compensation, depreciation, intangible asset amortization, and DD&A, is expected to result in significant improvements in the transparency provided to investors about the components of cost of sales and the drivers of gross margin. This, in turn, is expected to help investors assess gross margins.
c. Including certain expenses required to be disclosed under existing GAAP in the same tabular format disclosure that includes (a) and (b) would improve the transparency of the components of income statement expense captions by reducing the cost and effort required of investors to identify and locate the related information.
d. Disclosing qualitative information about amounts that have not been disaggregated and remain in relevant expense captions after disclosing (a), (b), and (c) would provide incremental information about the composition of those expense captions beyond what is currently provided.
e. Disclosing selling expenses and how selling expenses are determined is expected to help investors distinguish selling expenses from general and administrative expenses. Investors have communicated that they would prefer to forecast selling expenses separately from general and administrative expenses.
f. Requiring the disclosures for both annual and interim reporting periods would provide investors with more timely information, and more timely information may be more useful. The Board also expects that this requirement would enable investors to monitor entities throughout their respective fiscal years and update expectations for an entity's major individual expense captions throughout the year, rather than only when annual financial statements are issued. While the Board acknowledges that some entities present condensed financial statements in interim periods (which could affect the disaggregated expense disclosures), it determined that there would be significant benefits to requiring the proposed disclosures in interim periods.

BC119. The extent of incremental information that would be reported under the amendments in this proposed Update may vary across entities. However, the Board expects that nearly all entities, particularly those that present expense captions such as cost of sales and SG&A on the face of their income statements, would disclose significantly more information about the natural components of those expense captions than is commonly disclosed today. That incremental information should allow investors to better understand the components of an entity's expenses and more accurately forecast those expenses, which in turn should enable investors to better assess an entity's prospects for future cash flows. In addition, the Board notes that the enhanced information would benefit investors on an ongoing basis.

BC120. On the basis of feedback received in outreach with preparers, the Board understands that many entities would incur meaningful costs to implement the amendments in this proposed Update. Preparers indicated that it may be costly to provide the proposed disclosures because they do not currently map information for consolidated GAAP reporting purposes in a manner that would allow them to easily determine the amount of natural expenses (and how those expenses are allocated among various functions) from their existing accounting information systems. The Board understands that while source information is collected under current processes for the required expense categories, mapping and other system design approaches to producing consolidated GAAP financial statements were not developed with the amendments in this proposed Update in mind. Therefore, entities may encounter significant cost in modifying systems to capture such specific required data. The feedback also indicated that the proposed disclosures could result in both one-time costs that would be incurred to design and implement systems (including systems of internal controls) and ongoing costs that would be incurred to comply with the disaggregation requirements, particularly if manual processes are used to reduce the initial implementation costs. Both the one-time costs and the ongoing costs would vary depending on several factors, including the size and complexity of the entity, the extent to which the entity capitalizes costs to an asset such as inventory, the degree to which the entity allocates natural expenses across different functions presented in its current income statement, the extent to which the entity transacts in foreign currencies, and the extent to which management already collects or uses any of the required information.

BC121. In developing the amendments in this proposed Update, the Board made several decisions to mitigate implementation costs as follows:

a. Specific expenses. The Board decided to limit the disclosures to specific expenses and costs that it believes will be useful to investors. Feedback from preparers indicated that relative to an approach that would require the full disaggregation of functions by nature, the approach pursued by the Board would be less costly because fewer types of natural expenses would be required to be disclosed by function.
b. Use of costs incurred. Some preparers indicated that disaggregating the cost of sold inventory into the amounts expensed by nature would be impracticable. The approach pursued by the Board would be less costly because it would focus on the disaggregation of costs capitalized to inventory in the current period, rather than potentially requiring that an entity determine the nature of costs capitalized in previous periods on a per-unit basis.
c. Requiring costs capitalized to inventory to be combined with other manufacturing expenses. The Board decided to require that an entity combine costs capitalized to inventory with other manufacturing expenses in the inventory and manufacturing expense category. Feedback from preparers indicated that, under current cost accounting systems and processes, quantifying whether certain indirect costs and

amounts attributable to variances were capitalized to inventory or expensed as incurred during a reporting period would be difficult. Therefore, the Board decided to require that an entity disclose amounts of purchases of inventory, employee compensation, depreciation, intangible asset amortization, and DD&A that combine costs incurred that are either expensed as incurred or capitalized to inventory.

d. Other items remaining. The Board decided to require qualitative disclosure about the nature of expenses remaining in relevant expense captions rather than requiring additional quantitative disaggregation based on a quantitative threshold or principle.
e. Practical expedient on employee compensation. The Board decided to permit entities (banks and bank holding companies) applying SEC Regulation S-X Rule 9-04 that present salaries and employee benefits to continue using a classification that satisfies that requirement rather than requiring those entities to apply the employee compensation definition that would be included in Subtopic 220-40.
f. Classification discretion for certain categories. Rather than providing prescriptive guidance, the Board decided to permit entities to tailor the definitions of the terms *selling expenses, manufacturing expenses,* and *purchases of inventory* to their specific facts and circumstances. The Board expects that this would be less costly and more operable than if the Board had established prescriptive definitions of those terms to be applied by all entities; instead, entities would be permitted to apply reasonable judgment when defining those categories.
g. Private companies. The Board decided to exclude private companies from the scope of the proposed amendments.
h. Transition. The Board understands that much of the information required to prepare the proposed disclosures is not readily available today. Accordingly, the Board expects that it would be less costly to require that the proposed disclosures be applied prospectively rather than retrospectively.

BC122. Overall, the Board concluded that the expected benefits of the amendments in this proposed Update would justify the expected costs.

Amendments to the GAAP Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the “GAAP Taxonomy”). We welcome comments on these proposed improvements to the GAAP Taxonomy at xbrled@fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the GAAP Taxonomy will be finalized as part of the annual release process.