Staff paper

IASB Agenda reference 21C

FASB Agenda reference 21C

FASB | IASB Joint Education Meeting

Date	**30 September 2022**
Project	**Disaggregation—Income Statement Expenses (DISE)**
Topic	**Project Background and Next Steps**
Contacts	**Chris Bohdan (cbohdan@fasb.org); Mary Mazzella (mmazzella@fasb.org)**

Purpose of This Paper

1. This paper provides an overview of the background and history of the FASB's Disaggregation—Income Statement Expenses project (formerly named the Financial Performance Reporting—Disaggregation of Performance Information or "FPR" project) and provides an update on recent feedback received and next steps in the project.

Project History and Background

2. The FPR project was added to the FASB's technical agenda in September 2017. Before adding this project, the FASB contemplated disaggregation of income statement lines as part of broad proposals related to financial statement presentation and financial performance reporting. Between December 2019 and February 2022, the FPR project was paused to monitor the progress of the FASB's Segment Reporting project and the IASB's primary financial statements project. Following the February 2022 Board meeting, the project was renamed the Disaggregation—Income Statement Expenses ("DISE") project.

3. For business entities that follow U.S. GAAP, Topic 220, Income Statement—Reporting Comprehensive Income, does not contain any general requirements for specific expense captions on the face of the income statement.[1] Moreover, there is no broad requirement in U.S. GAAP that is analogous to the requirement in IAS 1, *Presentation of Financial Statements,* paragraph 104, which states that "[a]n entity classifying expenses by function shall disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense."

[1] Not-for-profit entities (NFPs), under U.S. GAAP, are required to 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. NFPs must present 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 professional fees.

4. By contrast, SEC Regulation S-X (17 CFR Part 210), Form and Content of and Requirements for Financial Statements, Securities Act of 1933, Securities Exchange Act of 1934, Investment Company Act of 1940, Investment Advisers Act of 1940, and Energy Policy and Conservation Act Of 1975 set forth the requirements for the form and content, including income statement presentation requirements, applicable to financial statements included in SEC filings. Those requirements do not apply to private company financial statements and the presentation and disclosure provisions do not apply to foreign private issuers that file financial statements prepared in accordance with IFRS.[2] Commercial and industrial companies are generally required to present certain expense captions by function, such as cost of sales and selling, general, and administrative expenses (SG&A).[3,4]

5. Before February 2022, the FASB had pursued two broad approaches as part of the FPR project for disaggregating performance information in the income statement, as follows:

   (a) *Nature and function (2018)*: Disaggregating functional expense line items, such as cost of revenues and SG&A into their natural components (for example, compensation, utilities, and rent).

   (b) *Internal view* (2019): Disaggregating income statement expense information based on how that information is viewed internally by management.

6. For the nature and function approach, the outreach indicated that there were three main challenges related to disaggregating functional line items into their natural components: (a) entities do not track natural expense information through the consolidation process, (b) entities do not track expenses that are allocated and reallocated between departments, divisions, and functions, and (c) acquisitive entities often have additional challenges related to the increased number and variety of accounting systems and complexity of the consolidation and allocation process. The IASB staff has noted that it received similar feedback during more recent outreach (see paragraphs A14 and B5 in the IASB's July 2022 meeting materials).

7. Moreover, as it relates to natural costs that are capitalized, the staff has noted that individual costs lose their identity when costs—such as wages, borrowing costs or overhead—are capitalized into the cost of an asset, such as inventory or a fixed asset. The unit of account from an entity's perspective is the unit of inventory or the fixed asset that can later be sold, depreciated, or amortized.

---

[2] As noted in the SEC's Financial Reporting Manual (6320.6), "foreign private issuers that file financial statements prepared in accordance with IFRS as issued by the IASB must comply with IASB requirements for form and content within the financial statements, rather than with the specific presentation and disclosure provisions in Articles 4, 5, 6, 7, 9, and 10 of Regulation S-X".

[3] Regulation S-X, Rule 5-01 states that the requirements for commercial and industrial companies applies to the "financial statements of all persons" except those of (a) Registered investment companies, (b) Employee stock purchase, savings and similar plans, (c) Insurance companies, (d) Bank holding companies and banks, and (e) Brokers and dealers when filing Form X-17A-5.

[4] Notwithstanding the guidance in SEC Regulation S-X, Rule 5-03 to present functional expense captions, some entities, such as airlines, have a longstanding industry practice of presenting expenses by nature on the face of their income statements.

8. For the internal view approach, some preparers did not identify an internal view of disaggregation that differed in any meaningful way from the view that already is presented in its financial statements or in management discussion and analysis (MD&A). Those that would provide incremental information expressed concern about reconciliation efforts (stemming from the use of non-GAAP internal metrics), internal control considerations, and competitive harm if disaggregated information based on the internal view was presented or disclosed.

9. Both of the aforementioned approaches were discussed during the July 23, 2019 joint Board meeting (see link to meeting materials).

10. On December 11, 2019, rather than pursue either of those approaches, the FASB directed its staff to pause additional research on this project and to monitor the progression of the Segment Reporting project and the IASB's primary Financial Statements project. This project remained on the FASB's active technical agenda, and the project team continued to monitor those projects and feedback received from stakeholders.

Invitation to Comment Feedback Received

11. In June 2021, the FASB issued Invitation to Comment (ITC), *Agenda Consultation,* to solicit broad feedback from stakeholders about its future standard-setting agenda. Chapter 1 of the ITC, "Disaggregation of Financial Reporting Information," notes that investors and other financial statement users cited a general need for greater disaggregation and granularity of a range of financial reporting information. Chapter 1 also includes a list of specific financial reporting areas for which investors requested greater granularity and disaggregation. Those areas include a breakdown of existing functional lines, such as cost of sales and SG&A expenses, to understand an entity's cost structure by nature (such as labor) and/or further by function (such as selling expenses separate from general and administrative expenses). Overall, the FASB received a total of more than 500 responses, including more than 70 responses from stakeholders that addressed the ITC broadly.[5]

12. Investors and financial statement users said that the FASB's top priorities should be including requiring greater disaggregation and granularity on the face of financial statements or in the notes. Specific areas cited included (a) a breakdown of cost of sales and SG&A expenses, (b) more information about workforce costs, (c) more information about recurring or nonrecurring income and expenses, and (d) greater disclosures related to research and development.

13. Several noninvestor respondents commented generally on potential costs and complexity related to greater disaggregation and granularity of financial reporting information. Most of those respondents,

[5] This excludes more than 400 responses from a variety of stakeholders that focused solely on the accounting for digital assets. Those respondents included academics, holders of digital assets, individuals, investors and other financial statement users, practitioners, and preparers.

including preparers, said that requiring greater disaggregation of financial reporting information would be costly for preparers and that those costs would not be likely to outweigh the benefits. For example, the costs associated with providing greater disaggregated information would include tracking, reporting, disclosing, and auditing the additional disaggregated information.

DISE Disaggregation Principle and/or Quantitative Backstop

February 2022 Board Meeting Discussion

13. In February 2022, the FASB decided to revise its project's objective and scope. The revised objective is to improve the decision usefulness of business entities' income statements through the disaggregation of certain expense captions. The current project's scope includes the following expense captions: (a) SG&A expenses, (b) cost of services and other cost of revenues, and (c) cost of tangible goods sold.

14. During the February 2022 Board meeting, the FASB commented on the project's next steps and described several potential approaches that could be pursued for the captions within the project's scope.

15. Some FASB members expressed interest in a disaggregation principle that would seek to disaggregate categories that respond differently to changes in economic conditions or that would leverage aspects of the disaggregation principle in Topic 606, Revenue from Contracts with Customers (an identical principle exists in IFRS 15, *Revenue from Contracts with Customers,* paragraph 114). The FASB also discussed quantitative thresholds or "backstops" as a way to require a minimum level of disaggregation and discussed how both those alternatives might be affected by issues such as inventoriable costs (because it may be challenging to disaggregate costs after they have been capitalized into inventory).

Stakeholder Feedback

16. The staff conducted outreach with preparers that are represented on the Financial Accounting Standards Advisory Council (FASAC) or have been represented on FASAC in the past. The purpose of the outreach was to solicit feedback on early-stage draft disaggregation principles.

17. Overall, those preparers provided mixed feedback on the disaggregation principles included in the materials (which were based on the existing revenue disaggregation principle). Mixed feedback was provided on (a) the ability of participants to understand which categories might be required under different versions of the principles presented, (b) what types of information would be presented under each proposed principle, and (c) the ability to use existing processes to disaggregate selling expenses from general and administrative expenses

18. However, there were notable areas of discussion that generally received consistent feedback. Those topics included (a) the need for either an overarching objective or a high-level principle that allows more flexibility, (b) challenges related to applying the quantitative threshold in scenarios in which no

meaningful categories exist that can be disaggregated from certain expense categories, (c) challenges associated with disaggregating inventory expense, and (d) the preference for disaggregating cost of sales and SG&A using different methods even if a single disaggregation principle applied to both expense captions.

19. Preparers on other advisory groups and the Private Company Council (PCC) either indicated that they were not in favor of additional disaggregation or would prefer a high-level principle for additional disaggregation. Specifically, preparers generally stated that they would prefer a disaggregation principle focused on "improving users' capacities to predict future performance" paired with examples of how the principle could be satisfied.

20. Users on advisory groups and the PCC indicated that they would expect better information to be provided under a high-level disaggregation principle than is currently provided. However, users also continued to assert that they would benefit from the disclosure of additional information about certain natural expenses (such as employee compensation costs). Disclosure of employee compensation costs was specifically mentioned by financial statement users as potentially providing decision-useful information. As a result, the feedback received from users on a disaggregation principle has been mixed; some have supported that approach as one that would provide more decision-useful information than is currently provided while others have continued to state that they would prefer the disaggregation of certain specific expenses to better enhance comparability.

DISE Disaggregation of Specific Expenses and Costs Incurred

July 2022 Board Meeting Discussion

Discussion of Overall Approach

21. During the July 2022 Board meeting, the FASB continued its discussion on paths forward based on feedback received during outreach with preparers and discussions with advisory groups and the PCC (which, collectively, represented all stakeholder types). During that meeting, the FASB discussed the approaches that the staff had solicited feedback on since the February 2022 Board meeting. The Board provided feedback on the direction of the project given the varied feedback from stakeholders about whether a disaggregation principle could be leveraged to achieve the project's objective.

22. FASB members discussed whether to pursue an approach that could share some similarities with the IASB's current direction. That approach would require, at a minimum, the disaggregation of certain specific information from all expense captions presented on the face of the income statement. FASB members also discussed subjecting any remaining expenses to a quantitative threshold or a disaggregation principle. During the meeting, the FASB discussed employee compensation,

depreciation, and amortization as potential information to consider for disaggregation from existing expense captions.

Discussion of Disaggregating Inventory Expenses Based on Costs Incurred

23. In the past, the FASB has received feedback that disaggregating the cost of sold inventory recognized as expense further by nature can be impracticable.[6]

24. Therefore, for expenses related to sold inventory, the FASB preliminarily discussed an approach that would disaggregate *costs incurred* (including purchases, employee compensation, depreciation, amortization, and others) that are capitalized during the period rather than requiring that *inventory expenses recognized* be disaggregated. The staff understands that this approach could be similar to how certain entities currently apply the requirements in IFRS Standards to disclose certain natural expenses in total.[7] The FASB discussed how a *costs incurred approach* could avoid issues associated with costs that lose their natural identity when they are capitalized to inventory.

25. Moreover, FASB members asked questions about and discussed other related issues, including if and how the disaggregated information resulting from the costs incurred approach would reconcile to the amounts presented on the face of an entity's income statement, whether other expenses that result from the derecognition of other internally generated assets (such as software) also should be subject to the costs incurred approach and whether the FASB would pursue disaggregation of selling expenses from SG&A as part of the project.

26. The FASB has not yet made any tentative decisions regarding the approach discussed during the July 2022 Board meeting. The staff is currently conducting additional research for consideration based on the direction that the Board provided the staff with at the July 2022 Board meeting.

Question

Question for the IASB—Feedback Received and Approach Pursued
Do IASB members have any questions or feedback about the FASB's direction or approach for this project?

[6] In FPR Board Memo 4, "Project Plan—Disaggregation of Performance Information," the staff noted that "individual costs lose their identity when costs, such as wages, borrowing costs or overhead, are capitalized into the cost of an asset, such as inventory, fixed asset, or a regulatory asset. The unit of account from the entity's perspective is the piece of inventory or the fixed asset that can later be sold, depreciated, or amortized."

[7] As noted in a previous IASB Board Memo, "determining nature expenses is often impracticable or prohibitively costly. Accordingly, the analysis of nature expenses will often actually be an analysis of nature *costs*. In those cases, the analysis of a function by nature will not add up to the total presented for the functional line item—the disaggregated amounts in the analysis will be cost amounts and the total for the functional line item will be an expense amount." [Footnote reference omitted; emphasis in original]