



STAFF PAPER

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IASB® meeting

Project	Primary Financial Statements	
Paper topic	Analysis of operating expenses by nature in the notes	
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Objective of this paper

1. This paper continues the IASB's discussions on the proposal in paragraph 72 of the Exposure Draft *General Presentation and Disclosures*. That paragraph requires an entity that presents an analysis of operating expenses by function in the statement of profit or loss to disclose, in a single note, an analysis of its total operating expenses by nature.
2. The staff does not make any recommendations or ask the IASB to make any decisions in this paper. Instead, as directed by the IASB at its October 2021 meeting, the staff analyses a partial matrix approach and seeks feedback on the proposed scope for future papers on the topic. The paper discusses what a partial matrix disclosure requirement might comprise, and the costs and benefits associated with such an approach compared to the proposal in the Exposure Draft, based on the feedback received.
3. The staff will bring back a future paper on the issues discussed in this paper in which the staff will ask the IASB to make decisions.

Structure of this paper

4. This paper is structured as follows:
 - (a) background (paragraphs 6–16);

- (b) discussions at the October 2021 IASB meeting (paragraphs 17–26);
 - (c) context—relationship between a potential requirement for a partial matrix and the general disaggregation requirement (paragraphs 27–29);
 - (d) information gathered on a partial matrix (paragraphs 30–66);
 - (e) should we further explore a partial matrix approach and if so which one? (paragraphs 67–80); and
 - (f) next steps (paragraphs 81–84).
5. The paper also has four appendices:
- (a) Appendix A—Feedback on the proposal in the Exposure Draft;
 - (b) Appendix B—Comparative overview of the costs relating to the proposal in the Exposure Draft and a partial matrix;
 - (c) Appendix C—Research on current practice of entities;
 - (d) Appendix D—FASB project ‘Disaggregation—Income Statement Expenses’.

Background

Proposal in paragraph 72 of the Exposure Draft (paragraphs 6–11 of this paper are identical to paragraphs 7–12 of October 2021 [Agenda Paper 21C](#))

6. The IASB proposed to require an entity that presents an analysis of operating expenses by function in the statement of profit or loss to also disclose, in a single note, an analysis of its total operating expenses by nature.
7. In the Basis for Conclusions that accompanied the Exposure Draft, the IASB explains its proposal would strengthen the existing requirements of IAS 1 *Presentation of Financial Statements*. Paragraph 104 of IAS 1 requires an entity that classifies expenses by function to “disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense”.
8. The IASB noted that both the nature of expense and the function of expense methods of analysis can provide useful information. For example, information that aggregates expenses by function facilitates the calculation of some performance metrics and

margins. However, the IASB had received feedback from users of financial statements that analysing expenses using the function of expense method can lead to a loss of useful information. Functional line items combine expenses with different natures that respond differently to changes in the economic environment, making it difficult for users to forecast future operating expenses. Information about the nature of operating expenses also enables direct comparisons with information provided in the statement of cash flows.

9. The IASB considered requiring entities to disclose an analysis of each functional line item by nature. Requiring this analysis would provide users of financial statements with information to help them better forecast an entity's functional line items. However, feedback from preparers of financial statements suggested that this approach would be significantly more complex and costly to apply than an analysis of *total* operating expenses using the nature of expense method. Hence the IASB decided to propose that limited requirement in the Exposure Draft.
10. The IASB also noted feedback from some preparers of financial statements that even the proposed requirement may be costly for entities to implement, particularly for those that operate multiple purchase systems making it difficult to track information about the nature of the total costs incurred. Such entities may not always retain information about the nature of the costs capitalised and, therefore, may find it difficult to disclose an analysis of expenses by nature. Other preparers, however, either provide this analysis today or could provide it with limited costs. The strong support for this proposal from users of financial statements led the IASB to conclude that the benefits of having information about operating expenses by nature would be likely to exceed the costs. The IASB noted that it intended to seek further feedback on the likely costs and benefits of the proposal during consultation on the Exposure Draft.
11. The IASB also considered requiring an entity that presents its primary analysis of expenses using the nature of expense method to disclose in the notes an analysis of expenses using the function of expense method. However, it rejected such a requirement because there was no evidence of demand from users of financial statements for this disclosure.

Objective of the proposal and how it fits into the context of the project

12. Overall, the Exposure Draft proposes improvements to the presentation and disclosure of information in an entity's financial statements with a focus on the statement of profit or loss (BC4 of the Basis for Conclusions).
13. The three main objectives of the Primary Financial Statements project are:
 - (a) improving the structure and content of the statement of financial performance by requiring defined subtotals in the statement of profit or loss;
 - (b) improving the quality of disaggregation in the financial statements;
 - (c) requiring disclosures about management performance measures.
14. To achieve the objective of improving the quality of disaggregation in the financial statements, the IASB proposed principles for aggregation and disaggregation and specific requirements—such as the requirement that an entity that reports operating expenses by function in the statement of profit or loss discloses, in a single note, an analysis of total operating expenses by nature (paragraph 72 of the Exposure Draft).
15. This proposal would strengthen the current requirement in paragraph 104 of IAS 1 which requires an entity that reports expenses by function in the statement of profit or loss to disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense. The IASB concluded this requirement needs strengthening because of the diversity in views on how it should be applied:
 - (a) some think paragraph 104 requires at least disclosure of the totals of those items alongside disclosure of totals of other (material) items;
 - (b) some think paragraph 104 only requires disclosure of totals of the items specified (that is, depreciation and amortisation and employee benefits).
16. Strengthening requirements for disclosure of operating expenses is not critical to meeting project objectives and on this basis the IASB could decide to remove this topic from the scope of the project to enable its timely conclusion. However, reverting back to the requirement in IAS 1 could risk being interpreted as confirmation that entities are only required to report totals for depreciation, amortisation, and employee benefits. Given that current practice by many entities is to report more than this, such

an interpretation could make current practice worse (see analysis of current practice in Appendix C).

Discussions at the October 2021 IASB meeting

17. The IASB discussed two papers in October 2021 with implications for the issues discussed in this paper:
- (a) [Agenda Paper 21B](#) *Analysis of operating expenses—presentation in the statement of profit or loss* (paragraphs 18–19); and
 - (b) [Agenda Paper 21C](#) *Analysis of operating expenses—disclosure in the notes* (paragraphs 20–26).

October 2021 [Agenda Paper 21B](#)

18. In October 2021 the IASB tentatively decided to withdraw the proposed prohibition on a mixed presentation of operating expenses in the statement of profit or loss¹ and instead to provide application guidance and disclosure requirements in order to improve comparability and help ensure the presentation of operating expenses provides a faithful representation of the expenses.
19. In particular, as part of the application guidance and disclosure requirements, the IASB tentatively decided to require an entity to disclose narrative accounting policy information to explain the composition of cost of sales and other functional line items, such as what types of expenses are included in cost of sales—referred to in this paper as a ‘narrative description of the composition of functions’ (paragraph 49 of October 2021 [Agenda Paper 21B](#)).

¹ Paragraph 68 of the Exposure Draft requires that an entity presents in the statement of profit or loss an analysis of operating expenses using *either* the nature of expense method *or* the function of expense method.

October 2021 [Agenda Paper 21C](#)

Staff recommendations in October 2021 [Agenda Paper 21C](#)

20. At the October 2021 IASB meeting the staff recommended in [Agenda Paper 21C](#) that the IASB explore providing a partial cost relief from the proposed requirement for an entity that presents an analysis of operating expenses by function in the statement of profit or loss to also disclose an analysis of its total operating expenses by nature. More specifically, the staff recommended exploring a partial cost relief that:
- (a) would exempt entities from disclosing information about operating expenses by nature if, and to the extent that, such disclosure would involve undue cost or effort;
 - (b) would not apply to:
 - (i) depreciation, amortisation, and employee benefits expenses; or
 - (ii) any other operating expenses by nature that are subject to specific disclosure requirements in IFRS Standards.
21. At that meeting the staff also recommended that if the IASB agreed to explore a partial cost relief it should reconsider its previous decision not to require an analysis of each functional line item by nature.

Summary of IASB's discussion of October 2021 [Agenda Paper 21C](#)

22. At the October 2021 IASB meeting the IASB discussed stakeholder feedback on the proposed requirement for an entity to disclose in the notes an analysis of total operating expenses by nature when it reports operating expenses by function in the statement of profit or loss, and the related staff recommendations.
23. Some IASB members highlighted that the objective of the proposal was to strengthen the existing requirement in IAS 1 and the improved transparency would be a significant benefit of the proposal. Many IASB members acknowledged that feedback, particularly from users, supported this view and that the information that would be provided would be useful. Some IASB members pointed out that some entities already disclose information about operating expenses by nature or use this

information internally on a more granular level further evidencing the usefulness of the information.

24. However, many IASB members also acknowledged the feedback, particularly from preparers, that for many entities the systems changes required to disclose totals of operating expenses by nature when it reports operating expenses by function would be costly. Some IASB members said the feedback suggested that the costs to entities was higher than the IASB originally anticipated.
25. The IASB tentatively decided not to explore providing a partial cost relief for the disclosure of information about totals of operating expenses by nature when an entity reports operating expenses by function in the statement of profit or loss. Many IASB members thought for many entities complying with the proposal would require a complete system overhaul. A cost relief based on undue cost or effort would therefore not strengthen the requirements because entities that are unable to present the analysis would use the cost relief. Some IASB members said that the IASB needed to decide whether the benefits of the proposal outweighed the cost and effort considering both the responses from preparers on costs involved and the responses from users on benefits of the information.
26. The IASB discussed alternative approaches to providing cost relief while maintaining as much of the benefit to users as possible. The IASB discussed the following potential approaches:
 - (a) a long transition period for entities which are unable to obtain the information from current systems. A few IASB members said this would provide time for entities to adapt systems. However, because of the fundamental system change required for many entities it would only delay rather than reduce the costs. Further, during the transition period there may be a lack of comparability between entities with systems able to provide the information and those required to change systems. In addition, entities which are able to provide the information may feel penalised because they would not benefit from a longer transition period.
 - (b) revising the proposal to require only some expenses by nature to be disclosed. Some IASB members asked whether specific expenses by nature could be

identified that would provide users with a significant portion of the benefit of the full by nature disclosure while reducing costs for preparers.

- (c) a partial matrix approach—disclosure of selected nature expenses disaggregated into the amounts included in each functional line item. One IASB member said that the benefit of this approach is the link it provides between the statement of financial performance and the cash flow statement. This IASB member also pointed out that comment letters from some preparers proposed a partial matrix as a feasible alternative to disclosure of all operating expense by nature. However, another IASB member raised a concern that a partial matrix would not reduce costs for entities. Some IASB members asked whether there was common understanding of a partial matrix approach and asked the staff to follow up on comments to assess this understanding.

Context—relationship between a potential requirement for a partial matrix and the general disaggregation requirement

- 27. At its meeting in April 2021, the IASB tentatively decided to establish a clear general requirement that amounts should be disaggregated in the notes to the financial statements whenever the disaggregated information is material. If such a requirement were applied to an analysis of operating expenses, it would effectively be the same as a specific requirement for a full matrix of operating expenses analysed by function and nature, and possibly by segment too. All material items in such a matrix would be required to be disclosed.
- 28. The advantage of such a high-level principled requirement is that it captures all information that is material for an entity. Feedback on the analysis of operating expenses indicates that what is material will vary between entities, meaning that requirements for specific items inevitably will not capture the most useful information for all entities.
- 29. However, there are two reasons why the staff think specific requirements are needed for the analysis of operating expenses:
 - (a) Paragraph 104 of IAS 1 already sets out a general requirement for an entity that classifies expenses by function to disclose additional information on the

nature of expenses. However, as explained in paragraph 15, practice varies on the extent of the information given. It seems that specific requirements are needed to achieve improvements in disclosure in this area.

- (b) As noted in paragraph 28, applying the general requirement to disclose disaggregated amounts whenever that information is material would be the same as a specific requirement for a full matrix analysing operating expenses by nature and function. Feedback indicates that such a requirement would be prohibitively costly. Hence, if such a requirement were to be established, some form of accompanying cost relief would also need to be established. The staff will bring to a future IASB meeting a paper that explores for all disclosure requirements in IFRS Accounting Standards the relationship between (i) the general requirement to disclose disaggregated amounts whenever material and (ii) the specific disclosure requirements, and whether any form of general cost relief is needed to accompany the general requirement. **In the meantime, the analysis of possible partial matrices in this paper assumes that compliance with any specific requirements relating to disclosure of operating expenses disaggregated by function and nature will result in sufficient disclosure of such disaggregated amounts. Accordingly, entities would *not* be required to also apply the general requirement (i.e., to populate a full matrix with all material information).**

Information gathered on a partial matrix

30. The following sections:
- (a) provide an analysis of comment letter feedback suggesting variants of a partial matrix approach (paragraphs 31–34);
 - (b) set out two variants of a partial matrix approach that staff sought feedback on in limited outreach (paragraphs 35–43); and
 - (c) summarise feedback from limited outreach on costs and benefits of the two variants of a partial matrix approach (paragraphs 44–66).

Suggestions for a partial matrix approach from comment letter respondents

31. A few comment letters, mostly from preparers and their representative bodies, said that showing the split between functional line items of each item required by paragraph 104 of IAS 1 (a partial matrix) was a more practical approach than the proposal in the Exposure Draft because disaggregated information on depreciation, amortisation, and employee benefits was more likely to be available from existing reporting processes (and could therefore be reported without excessive cost).
32. A few comment letters from users reiterated that the most useful information was a full matrix but that a partial matrix covering the majority of nature expenses would be more helpful than the proposal in the Exposure Draft, highlighting in particular that:
 - (a) employee benefits should be shown by function because they are often the largest expense for services and technology companies and that having such information would be crucial to understanding an entity's core competencies, competitive position, and vulnerability to economic disruption;
 - (b) depreciation and amortisation should be shown by function, because users would want to remove these expenses from research and development expenses (R&D) and make their own calculations with regards to the capitalisation of development expenses;
 - (c) even a rough approximation of the nature expenses included in functions would be of significant value to users; and
 - (d) more information on restructuring costs was needed by users.
33. While the comment letter feedback suggested that more detail about particular nature expenses or particular functions could provide useful information and may be less costly than fully implementing the proposal in the Exposure Draft, the feedback was not enough to conclude:
 - (a) what would such a partial matrix approach look like;
 - (b) how the costs and benefits of such an approach would compare with the proposal in the Exposure Draft.
34. We have therefore developed two variants of a partial matrix and conducted targeted outreach to assess their costs and benefits.

Variants of a partial matrix approach

35. The two variants of a partial matrix developed by the staff are:
- (a) specified nature expenses² are fully disaggregated by function (referred to as ‘partial matrix 1 approach’); or
 - (b) specified functions are fully disaggregated into nature expenses (referred to as ‘partial matrix 2 approach’).
36. As their name suggests, neither partial matrix would require all material information to be disclosed, and the partial matrices give different information about totals of expenses, as explained in paragraphs 37–43.

² By ‘nature expenses’ we mean operating expenses of a specific nature (e.g., depreciation, amortisation, employee benefits).

Partial matrix 1 approach—Specified nature expenses are disaggregated by function

37. The IASB could require an entity to disaggregate specified nature expenses by functions. The specified nature expenses could be the items explicitly listed in paragraph 104 of IAS 1—that is, depreciation, amortisation, employee benefits.
38. The table below illustrates how a partial matrix 1 approach could look like in the notes to the financial statements.

Partial matrix 1 approach	20X2	20X1
Depreciation	500	...
Cost of sales	250	...
Selling expenses	100	...
General and administrative expenses	100	...
Research and development expenses	50	...
Amortisation	50	...
Selling expenses	50	...
Employee benefits	500	...
Cost of sales	150	...
Selling expenses	150	...
General and administrative expenses	100	...
Research and development expenses	100	...

39. The amounts disclosed for each function would add up to totals of depreciation, amortisation, and employee benefits. However, information about nature expenses not specified in the requirement would not be required, including totals for those nature expenses, even if that information were material. The question of whether additional information should be required, for example either a disaggregation of additional nature expenses or totals for some or all other nature expenses is part of the next steps the IASB would need to consider if proceeding with such an approach (paragraph 84).

Partial matrix 2 approach—Specified functions are disaggregated into nature expenses

40. The IASB could require specific functions to be disaggregated into entity-specific material nature expenses—for example, the functions ‘cost of sales’ and ‘selling expenses’³.
41. The table below illustrates how a partial matrix 2 approach could look like in the notes to the financial statements.

Partial matrix 2 approach	20X2	20X1
Cost of sales	1000	...
Depreciation	250	...
Employee benefits	150	...
Materials	550	...
Impairment	25	...
Other	25	...
Selling expenses	500	...
Depreciation	100	...
Amortisation	50	...
Employee benefits	150	...
Materials	200	...

42. Such an approach would lead to entity-specific material information being given for the functions specified (e.g., cost of sales, selling expenses). However, information on functions not specified would not be required (other than narrative accounting policy information to explain the content of functions, see paragraph 19).

³ An entity might report selling, general and administrative expenses (SG&A) in the statement of profit or loss due to such presentation achieving an understandable overview. To fulfil the disclosure requirement, an entity would first have to disaggregate SG&A into ‘selling expenses’ and ‘general and administrative expenses’ and then disclose the nature expenses included in ‘selling expenses’.

43. In addition, partial matrix 2 has particular implications for the disclosure of totals for operating expenses:
- (a) if a portion of the total amount of a nature expense (e.g., depreciation) is included in a function for which disaggregation is not required, a total for that nature expense would not necessarily be determinable from the information provided in the matrix; and
 - (b) as explained in paragraph 49, 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 these 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.⁴

Limited outreach feedback on partial matrix approaches

44. Following the IASB’s October 2021 meeting, the staff have discussed the costs and benefits of a partial matrix approach, using the two variants of approaches described in paragraphs 37–43 of this paper, in:
- (a) outreach with the IASB’s consultative bodies, in particular:
 - (i) the Global Preparers Forum (GPF) at the November 2021 meeting;
 - (ii) the Capital Markets Advisory Committee (CMAC) at the March 2022 meeting; and
 - (iii) the Accounting Standards Advisory Forum (ASAF) at the March/April 2022 meeting.
 - (b) follow-up discussions with preparers and users who had suggested a partial matrix approach in their comment letters.

⁴ An equivalent disconnect between the disaggregated amounts and the total does not exist in partial matrix 1 because both the disaggregated amounts and the total are nature items. Hence both disaggregated amounts and the total will often actually be costs, not expenses.

45. The feedback on the costs and benefits of a partial matrix approach from GPF, CMAC and ASAF members and other preparers and users indicates that:
- (a) both partial matrices can be challenging to implement and may result in material information not being disclosed (paragraphs 46–49); but
 - (b) partial matrix 1 is likely to be:
 - (i) less costly than the proposal in the Exposure Draft for *some* entities (paragraph 50); and
 - (ii) more useful than the proposal in the Exposure Draft for *most* users (paragraph 58);
 - (c) partial matrix 2 is likely to be:
 - (i) equally (or more) costly than the proposal in the Exposure Draft for *most* entities (paragraph 51); but
 - (ii) more useful than the proposal in the Exposure Draft for *most* users (and more useful than partial matrix 1 for *many* users) (paragraph 59).

Feedback on the costs of obtaining information about nature expenses in general

46. Many GPF members and other preparers (‘preparers’) as well as some ASAF members raised cost concerns on a partial matrix approach that were similar to those raised on the proposal in the Exposure Draft (see Appendix A), with additional detail. Paragraphs 47–51 summarise the feedback (see also table in Appendix B which gives a comparative overview of the costs relating to the proposal in the Exposure Draft, partial matrix 1 and partial matrix 2).
47. The underlying reason for the concerns about providing information about nature expenses is that such information is generally not tracked at the reporting entity level. Entities generally manage their business by using information on the nature of expenses only at a lower level. For example, when a reporting entity reports operating expenses by functions, the information reported for financial reporting purposes to the reporting entity will be based on functional cost centre information created at the lower reporting levels. The detail of the nature amounts charged to those cost centres may not be reported to the reporting entity. Accordingly, to obtain information about

nature expenses at the reporting entity level, an entity would be required to either make system changes or to collect the information manually.

48. Further, specific problems arise in collecting the information at a reporting entity level:
- (a) for cost of sales, obtaining information on the nature of expenses included in cost of sales would be challenging because entities using standard-costing systems are not able to ‘unbundle’ standard costs (under a standard costing system amounts are reported as one line to cost of sales—hence no information on the nature of expenses is available from financial accounting systems). Furthermore, obtaining information would be even more difficult if a manufacturing process involves multiple locations and standard costing systems and costs in multiple currencies—the standard costs of one manufacturing location are the ‘material costs’ of the next manufacturing location. Hence, information on ‘inputs’ (e.g., material costs, staff, overhead) would be lost after each manufacturing step.
 - (b) challenges in collecting information may arise at the legal entity level because of *intracompany*⁵ re-charging of costs initially bundled in a specific cost centre (linked to a specific function) and re-charged to other functions resulting in a loss of information on the initial nature of the re-charged expenses (e.g., staff costs for employees working in the IT department are re-charged as IT-costs to a specific function—leading to such costs being comingled with costs for third-party IT services).
 - (c) elimination of *intercompany*⁶ transactions during consolidation is by function (e.g., intercompany re-charging of costs, intercompany sale of goods or intercompany loans).

⁵ Intracompany re-chargings are re-chargings of expenses from one function to another function *within* the same legal entity.

⁶ Intercompany transactions are transactions that occur *between* legal entities of the same group.

49. In addition to the challenges of obtaining information at a reporting entity level, determining *expense* amounts for nature expenses rather than *cost* amounts is also challenging:
- (a) generally: for a specific nature cost incurred in the period (including depreciation and amortisation charge) it may be difficult to distinguish between:
 - (i) cost incurred that has been expensed in the period; and
 - (ii) cost incurred that has been included in the carrying amount of an asset (e.g., property, plant, and equipment);
 - (b) specifically for cost of sales: it is not possible to determine the exact amounts of specific nature costs that were included in the carrying amount of sold inventory (and recognised as an expense).

Feedback on the costs of specific partial matrix approaches

50. Some preparers said that a partial matrix 1 approach would be less costly than the proposal in the Exposure Draft, and less costly than partial matrix 2, because it was easier to obtain information on a *limited number of specified* nature expenses. Preparers had indicated they might be able to gather information on depreciation, amortisation, and employee benefits by:
- (a) extending legal entity reporting packages to incorporate the required information;
 - (b) obtaining such information from other systems (e.g., payroll systems); or
 - (c) building ‘workarounds’ to obtain the amount of depreciation, amortisation, and employee benefits included in the respective functions (some preparers highlighted that totals of depreciation, amortisation, and employee benefits were already collected because of the current disclosure requirement in paragraph 104 of IAS 1).
51. In contrast, the proposal in the Exposure Draft would require an entity to determine which nature expenses would be material and collect information for all such items. That might involve having to re-assess which nature expenses are material (because what is material might change over time). Further, feedback from many preparers

indicates that partial matrix 2 would be even more costly than the proposal in the Exposure Draft because an entity would need to assess what nature expenses included in the specified functions at each reporting date would be material and would need to collect information about the amount of those nature expenses included in the specified functions.

Feedback on the usefulness of both partial matrix approaches

52. Some users said that it would be most beneficial if an entity were to give entity-specific material information (a full matrix), rather than the IASB specifying the nature expenses to be disclosed by function or the functions to be disaggregated into nature expenses.
53. With regards to a partial matrix approach, some users and a few ASAF members were concerned that specifying the nature expenses to be disaggregated by function or specifying the functions to be disaggregated would not be a principle-based approach and bear the risk of entity-specific material information not being given. A few users said that the IASB's tentative decision in October 2021 to require that an entity gives a narrative description of the expenses included in functions could complement quantitative information, but that quantitative information is crucial for users when calculating metrics or comparing entities. One user explained that it would be sufficient for users if narrative information was accompanied by estimations rather than precise amounts (e.g., if an entity discloses a percentage range of depreciation in cost of sales).
54. One preparer and some users questioned the usefulness of consolidated (partial matrix) information for complex businesses where an entity has multiple business units/lines—each have widely differing margins. Some users said they would prefer information on the segment (or division) level—as users develop their models at this level and sales volume/prices are only understandable at this level. In addition, the preparer explained that providing information on specific nature expenses by segment would be easier to obtain than information on specific nature expenses by function.
55. Most CMAC members and other users ('users') as well as some ASAF members were supportive of a partial matrix approach because such an approach would help users better understand the composition of functions and help users in:

- (a) valuing an entity;
- (b) forecasting cash flows;
- (c) understanding an entity's cost drivers;
- (d) linking the statement of profit or loss to the statement of cash flows.

Feedback on the usefulness of specific matrix approaches

56. A few users and one ASAF member said that the question of which variant provides users with more benefits is likely to depend on the entity's business model and the industry in which it operates, for example:
- (a) a partial matrix 1 is likely to be more beneficial when analysing asset-heavy entities (for which depreciation and employee benefits would account for most of the expenses); while
 - (b) a partial matrix 2 is likely to be more beneficial when analysing an entity in the software as a service (SaaS) business (for which costs other than depreciation and employee benefits would account for most of the expenses).
57. Overall, users expressed mixed views about the preferred variant of a partial matrix. Most users agreed that having disaggregated information on depreciation, amortisation, and employee benefits by function (partial matrix 1) was useful—however, many users were more supportive of partial matrix 2.
58. A few users said that having as much information as possible on depreciation, amortisation, and employee benefits is important to them—thus, they preferred partial matrix 1. One of these users explained that they were seeking to strip out depreciation, amortisation and employee benefits when modelling functions (or EBITDA) as they wanted to make their own calculations with regards to depreciation and amortisation.
59. Many users said that partial matrix 2 has important benefits because it would:
- (a) allow users to better understand the composition of important functions which helps users:
 - (i) understand the cost drivers of an entity better: for example, it would provide information on material costs (e.g., steel) included in cost of sales, or help users distinguish between ongoing general and

administrative expenses and selling expenses (such as advertising and marketing expenses that relate to future sales);

- (ii) make their own adjustments when calculating metrics related to cost of sales or SG&A;
 - (iii) compare entities—because there is diversity in practice with regards to what is included in functions (e.g., understanding the composition of cost of sales is important when forecasting an entity’s gross margins or comparing various entities’ gross margins because information on the composition of functions allows users to adjust gross margins);
- (b) give insights into changes in cost drivers—because changes in cost drivers would lead to an entity having to disclose specific (material) nature expenses that were previously not disclosed due to them being immaterial;
 - (c) make digital consumption easier because disaggregated items are expected to add up to the total (functional line item).

60. However, a few users also said that disaggregation of ‘cost of sales’ and ‘selling’ would not be enough as they also need more information on the nature expenses included in research and development expenses (R&D). In addition, a few users also said they would like an even greater level of disaggregation than functions into nature expense (e.g., would want to be able to distinguish between expenses that are fixed and expenses that are variable in nature, or between cash and non-cash expenses).

Additional comments on a partial matrix approach

61. A few preparers also said that many entities already voluntarily provide disaggregated information on depreciation, amortisation, or impairments in the notes to the financial statements (our research of a limited sample of entities indicates some entities provide this analysis, see Appendix C).

62. One ASAF member said that large entities in their jurisdiction would be able to provide information required by both partial matrix 1 and partial matrix 2 (because such entities have sophisticated reporting systems in place) but may be reluctant to disclose such information due to it being commercially sensitive in their view. This

ASAF member also said that medium-size and small entities may face more challenges than large entities in providing disaggregated information.

63. One preparer said it would be unlikely that they early adopt the final Standard if the IASB proposes a partial matrix approach (because they estimated 2–3 years for necessary systems changes).
64. A few preparers said that users were currently not requesting this information and wanted to better understand why users were seeking information that is not used internally by entities to manage their business (one ASAF member said they had heard similar feedback from preparers in their jurisdiction).
65. A few ASAF members said that specific disclosure requirements applying only to entities reporting operating expenses by function would be an asymmetric treatment of those entities compared to entities reporting operating expenses by nature.
66. One ASAF member said stakeholders in their jurisdiction would prefer the disclosure requirements in the final Standard to be more closely aligned with regulatory disclosure requirements.

Question for the IASB

Question 1

Does the IASB have any questions or comments on the information gathered about the partial matrix approaches?

Should we further explore a partial matrix approach and if so which one?

67. This section discusses:
- (a) whether a partial matrix disclosure requirement would strengthen the requirements in IAS 1 (paragraphs 68–72);
 - (b) which partial matrix is likely to provide a better balance of costs and benefits (paragraphs 73–74);
 - (c) which approach should be further explored (paragraphs 75–80).

Would a partial matrix disclosure requirement strengthen the requirements in IAS 1?

68. Paragraphs 12–16 of this paper explain that the IASB intended the proposals in the Exposure Draft to strengthen the requirements in IAS 1 and thereby improve the extent of information given about operating expenses. Paragraph 104 of IAS 1 requires an entity classifying expenses by function to disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense. The proposals in the Exposure Draft strengthened the requirements in IAS 1 because they would have explicitly required an analysis of total operating expenses by nature.
69. The partial matrices described in paragraphs 35–43 of this paper would require different information from the requirement in IAS 1 or that proposed in the Exposure Draft. As a result, they would strengthen the requirement in some respects but also potentially weaken it in others.
70. Partial matrix 1 would:
- (a) strengthen the requirement in IAS 1 for depreciation, amortisation expenses, and employee benefits—because these expenses would be required to be disaggregated by each function rather than just provided as totals;⁷ but

⁷ Totals of depreciation, amortisation, and employee benefits would be either implicitly required or explicitly required (follow-up question IASB would need to consider, see paragraph 84).

- (b) could weaken the requirement in IAS 1 for additional information about expenses of a nature other than depreciation, amortisation, or employee benefits—because these expenses would no longer be required to be disclosed even if material.

71. Partial matrix 2 would:

- (a) strengthen the requirement in IAS 1—because additional information on nature expenses would be required for specific functions; but
- (b) could weaken the requirement in IAS 1 in two ways—firstly, because information about total expenses for depreciation, amortisation, and employee benefits would not be provided by the matrix⁸, and secondly because information about material nature expenses included in functions which are not specified would also not be provided by the matrix (paragraph 43).

72. To better understand the likely effect of a partial matrix requirement on practice, the staff have analysed current practice (see Appendix C). This analysis suggests that many entities do not provide the analysis that would be required by partial matrix 1 or 2 and therefore implementing the requirement for a partial matrix would improve current practice.

How do partial matrix approaches balance costs and benefits?

73. The feedback received indicates that (paragraphs 44–66):

- (a) partial matrix 1 is likely to be:
 - (i) less costly than the proposal in the Exposure Draft for *some* entities (paragraph 50); and
 - (ii) more useful than the proposal in the Exposure Draft for *most* users (paragraph 58);
- (b) partial matrix 2 is likely to be:

⁸ The requirements for partial matrix 2 could include a requirement to disclose totals for depreciation, amortisation, and employee benefits, which would alleviate this potential loss of information.

- (i) equally (or more) costly than the proposal in the Exposure Draft for *most* entities (paragraph 51); but
- (ii) more useful than the proposal in the Exposure Draft for *most* users (and more useful than partial matrix 1 for *many* users) (paragraph 59).

74. Looking at the costs in detail, the feedback from preparers has indicated that:

- (a) partial matrix 1 is likely to be less costly than the proposal in the Exposure Draft for *some* entities because the required information could be obtained at little additional cost (paragraph 50); but that
- (b) both the proposal in the Exposure Draft and partial matrix 2 would require substantial changes to systems and processes for *most* entities—thus would involve significant costs for *those* entities (paragraphs 46–49 and paragraph 51); and
- (c) partial matrix 2 may be even more costly than the proposal in the Exposure Draft because disaggregating cost of sales would be even more challenging than providing totals of nature expenses (paragraph 51).

Which approach do we explore further?

75. The objective of considering partial matrix approaches was to reduce the cost of disclosures about operating expenses for entities that report expenses by function, compared to the cost of implementing the proposal in the Exposure Draft. Compared to the proposal in the Exposure Draft, partial matrix 2 is likely to provide users with more benefits but is also likely to be more costly to implement.

76. The IASB could explore partial matrix 2 further, on the basis of providing additional benefits to users. The staff however do not suggest IASB further explores partial matrix 2 because doing so:

- (a) would not be responsive to the feedback received on the Exposure Draft;
- (b) could be considered a fundamental change to the proposal in the Exposure Draft and thus could delay the project; and
- (c) would not significantly contribute to meeting project objectives.

77. In contrast, the staff think that partial matrix 1 is worth exploring further because:
- (a) the requirements are expected to result in the disclosure of additional material information by many entities, and thus improve current practice; and
 - (b) the preparer feedback suggests that, even for entities that do not already provide this information, this information can be provided either with little additional cost or without undue cost.
78. Similar to partial matrix 2, partial matrix 1 could be seen as a fundamental change to the proposal in the Exposure Draft. Nonetheless, the staff think it is worth exploring further because of its potential benefits for users and reduced costs for some preparers.
79. The staff acknowledge that some users would find nature expenses disaggregated by segment more useful and that preparers may be able to obtain such information more easily from current systems than nature expenses disaggregated by function (paragraph 54). In addition, staff research shows that many entities that report expenses by function in the statement of profit or loss already provide such information to some extent, specifically:
- (a) 66% disaggregate depreciation and amortisation by segment (31 out of 47 entities); and
 - (b) 43% disaggregate impairments by segment (20 out of 47 entities) (paragraph C6 in Appendix C).
80. However, such a disclosure requirement would not be in the scope of this project but rather in the scope of IFRS 8 *Operating Segments*. Hence, the staff do not plan to consider this issue further in this project.

Question for the IASB

Question 2

Does the IASB have any questions or comments on the staff plan on which partial matrix approach to explore in the next paper?

Next steps

What research and outreach we plan to do before the next IASB discussion?

81. We are conducting research of current practice of disclosing nature expenses to help the IASB assess the effect of different approaches on reporting in practice. The Appendix C to this paper includes an analysis of the sample of 100 entities we used in the analysis of the effects in the Exposure Draft, focusing on 47 entities in the sample that report expenses by function. For example, this analysis shows that:
- (a) many entities provide a full analysis of nature expenses, but most do not;
 - (b) some entities provide an analysis of depreciation, amortisation and employee benefits by some functions, and some entities also provide an analysis of impairment by functions; and
 - (c) most entities provide some analysis of expenses by segments, with most providing an analysis of depreciation and amortisation by segment.
82. We are currently conducting additional research on the effects of a partial matrix approach and plan to include any incremental findings in the next paper.
83. We do not think additional outreach is needed before we ask the IASB to make decisions.

What questions we plan to cover in the next IASB papers?

84. To enable the IASB to finalise the proposals relating to an analysis of operating expenses by nature for entities that report expenses by function, we plan to analyse the following questions in the next set of papers (for some questions we will be able to build on the analysis already done in the papers for the October IASB meeting):
- (a) should entities be required to provide information about specified nature expenses disaggregated by functions and, if so, should any expenses beyond depreciation, amortisation and employee benefits be specified?
 - (b) if the IASB requires information about specified nature expenses disaggregated by functions, should:

- (i) there be a specific requirement for disclosure of totals for nature expenses in the new IFRS Accounting Standard; and, if so,
 - (ii) should this specific requirement be limited to the totals of specified nature expenses?
- (c) the analysis in this paper assumes that the general requirement to disclose disaggregated amounts whenever the disaggregated information is material would not apply in addition to specific requirements for disclosure of operating expenses by nature (see paragraph 29(b)). Is that approach the best way to avoid a requirement for a full matrix, or should the IASB keep the general requirement in place together with a cost relief?
- (d) is additional application guidance needed, for example relating to:
- (i) the disclosure of costs incurred as opposed to expenses (see paragraph 43(b));
 - (ii) disaggregation of functions, for example whether entities would need to separately identify specified expenses related to selling expenses rather than specified expenses relating to selling, general and administrative expenses; and
 - (iii) any implications of the IASB's tentative decision to permit mixed presentation of operating expenses in the statement of profit or loss that need to be considered when developing the proposals for an analysis of operating expenses in the notes?

Question for the IASB

Question 3

Does the IASB have any questions or comments on the planned next steps? Specifically, is there additional research you would suggest or additional questions the staff should analyse?

Appendix A—Feedback on the proposal in the Exposure Draft (identical to paragraphs 13–22 of October 2021 [Agenda Paper 21C](#))

Agreement

- A1. Many respondents, mainly users, standard-setters, and accountancy bodies, agreed with the proposed requirement for an entity to disclose an analysis of expenses by nature in the notes if it presents an analysis of expenses by function in the statement of profit or loss. These stakeholders generally said that the proposed approach appears to strike a reasonable balance between user needs, complexity, and practicality. These respondents said the analysis of operating expenses by nature:
- (a) would provide comprehensive information and help users make forecasts and calculate EBITDA;
 - (b) would help users reconcile the statement of cash flows with the statement of profit or loss; and
 - (c) is less judgmental than analysis by function, and therefore enhances comparability both from period to period for a reporting entity and in a single period across entities.
- A2. A few respondents, mostly users, said that the analysis of expenses by nature should be required not only in the annual financial statements, but also in the interim financial statements.⁹

Concerns

- A3. Many respondents, mainly preparers and their representative bodies, disagreed with the IASB’s proposed requirements. They said:
- (a) the cost of providing such information will be higher than the benefits. Entities that currently present operating expenses by functions do so because this is how they run their business and monitor performance internally. These companies would have to maintain two statements of profit or loss and maintain dual systems of reporting of operating expenses—by functions for

⁹ Disclosure requirements in interim financial statements will be discussed in a future paper.

internal reporting and performance monitoring, and by nature for external reporting. They said that if the analysis of expenses by nature is prepared solely to meet an external disclosure requirement, the ability of management to answer questions about those expenses or trends is likely to be limited.

- (b) some entities may not be able to analyse operating expenses by more than one method in their reporting systems. Therefore, these entities would need to incur additional costs to track operating expenses using the other method of presentation outside of their current systems.
- (c) both methods of presentation provide relevant information, but the IASB's proposals seem to favour by nature analysis of operating expenses.
- (d) they are unclear about why an entity should be required to disclose in a single note total operating expenses by nature if, applying paragraph 68 of the Exposure Draft, the entity has already determined that the presentation by function provides the most useful information. They think that the requirement is unnecessary.
- (e) IFRS 17 provides presentation guidance and takes precedent for insurance contracts by effectively requiring presentation of operating expenses by functions. Insurers said that they have not heard from users of their financial statements that the analysis of total operating expenses by nature would be needed and questioned the usefulness of information provided by such analysis.

A4. A few respondents who agreed with the proposals also acknowledged that the proposed requirements could result in additional costs for preparers presenting operating expenses by functions, because they may not have adequate reporting systems in place.

Alternative suggestions

A5. To address cost concerns, some respondents suggested that the IASB should further extend its cost and benefit analysis by, for example, investigating which information about operating expenses by nature is fundamental for users of financial statements and whether the costs of providing such information would outweigh the benefits for

users. Some respondents, including some users in discussions during outreach, suggested that, to alleviate the costs of application, the IASB should consider extending the scope of current requirements in IAS 1 by requiring disclosure of specified expenses by nature, in addition to those expenses by nature specifically required by IAS 1 (depreciation, amortisation and employee benefits expense), instead of requiring a complete analysis of operating expenses by nature.

- A6. A few users (comprising a global professional body and investor representative groups), as well as a regional standard-setter, said they would like the requirements to go further, and that entities should be required to present an analysis of expenses by nature, for each function, rather than for total operating expenses. They sometimes refer to this as matrix approach. To alleviate the cost, some of these users said a partial matrix may be sufficient to meet user needs. These users said that a partial matrix approach would provide a partial analysis of expenses by function by disclosing quantitative information about key expenses by nature included in each function (such as employee benefits, depreciation, and amortisation).
- A7. A few respondents, including a user professional body, suggested that the IASB should also consider requiring entities to disclose in the notes operating expenses by function, if in the statement of profit or loss they present the analysis of operating expenses by nature. Some of these respondents said that they do not consider one of the two methods to be superior to the other, because each of them provides relevant information—presentation of operating expenses by nature helps forecast future performance, while presentation by function helps evaluate past performance and compare gross profit.

Fieldwork findings

- A8. Most participants that presented an analysis of expenses using the function of expense method were either unable to disclose an analysis of operating expenses using the nature of expense method or required significant estimates to disclose expenses using the nature of expense method using their existing systems (23 participants out of 29 participants that presented all or most operating expenses by function). These participants said that their existing systems were unable to provide a full analysis of expenses by nature because the nature of operating expenses:

- (a) generally is not tracked by the system—for example, one participant said that particular types of operating expenses by nature are tracked because of specific disclosure requirements in IFRS Standards but the remainder are not tracked;
- (b) is tracked where incurred (typically at a subsidiary level) but cannot be easily aggregated at a consolidated level because of consolidation by function; or
- (c) is changed or lost as a result of intercompany transactions, for example, when the output of one group entity is the input of another group entity.

A9. The extent of systems challenges for participants presenting the analysis of expenses using the function of expense method varied by participant depending on the structure and level of integration of existing systems and the complexity of operations. Many of these participants said that employee costs, depreciation and amortisation are easily obtained from existing systems. However, most of these participants said that disclosing the analysis of operating expenses by nature to the level of accuracy expected to be required for audit would require significant changes to existing systems and processes that would be costly and time consuming.

A10. A few participants that presented the analysis of expenses by function said that they were able to provide the analysis of expenses by nature because they are already required to prepare subsidiary accounts using the nature of expense method by local regulations.

Appendix B—Comparative overview of the costs relating to the proposal in the Exposure Draft and a partial matrix

	Main costs for entities (see also paragraphs 46–51)			
	Collection of cost centre information at reporting entity level	Unbundling of standard costs	Identification of nature of re-charged costs (intracompany re-charging)	Elimination of intercompany transactions (consolidation)
Exposure Draft proposal	Yes, but limited to collection of totals of nature expenses	No, information expected to be generated from other systems (e.g., purchase and payroll systems)	Yes	Yes
Partial matrix 1	Yes, collection of information on allocation of totals to functions required for <i>specified</i> nature expenses	Yes, some unbundling would be required (e.g., employee benefits), but workarounds perhaps available to obtain information	Yes, but limited to <i>specified</i> nature expenses	Yes
Partial matrix 2	Yes, collection of information on allocation of totals to functions required for <i>all</i> nature expenses included in <i>specified</i> functions	Yes, because cost of sales is expected to be a specified function	Yes	Yes

Appendix C—Research on current practice of entities

- C1. The staff conducted research on 100 sample entities' 2020–2021 financial statements. The staff analysed:
- (a) the presentation method in the statement of profit or loss of these 100 entities (paragraph C2); and
 - (b) for those entities that present expenses by function in the statement of profit or loss, whether they provide:
 - (i) a complete or limited analysis of nature expenses in the notes to the financial statements (paragraphs C3–C4);
 - (ii) disaggregation of functions into nature expenses (paragraph C5); or
 - (iii) disaggregation of segments into nature expenses or by functions (paragraph C6).

Presentation method in the statement of profit or loss

- C2. For the 100 entities analysed by staff, the research shows that:
- (a) 47% present expenses by function (47 out of 100 entities);
 - (b) 18% present expenses by nature (18 out of 100 entities);
 - (c) 32% use a mixed presentation method (32 out of 100 entities); and
 - (d) 3% do not give an analysis of expenses in the statement of profit or loss (3 out of 100 entities).

Current practice of entities reporting expenses by function

Analysis of nature expenses in the notes

- C3. The staff analysed how many entities that report expenses by function disclose a **complete analysis** of nature expenses (that is, disclose totals of *all* nature expenses) and how many disclose a **limited analysis** of nature expenses in the notes to the financial statements (that is, disclose totals of *some* nature expenses). The research shows that:

(a) 40% (19 out of 47 entities) provide a complete analysis of nature expenses; whereas

(b) 60% (28 out of 47 entities) provide a limited analysis of nature expenses.

C4. Entities that provide a limited analysis of nature expenses mostly provide totals of depreciation, amortisation, employee benefits, or impairments. A few entities also provide totals of other expenses (e.g., research and development expenses, audit fees).

Disaggregation of functions into nature expenses

C5. The staff analysed how many entities disaggregate (some) functions into nature expenses—focusing explicitly on depreciation, amortisation, employee benefits and impairments. The research shows that 19% (9 out of 47 entities) provide disaggregated information on (some) functions to some extent (see table 1).

Table 1—Disaggregation of functions into depreciation, amortisation, employee benefits, and impairments

	Number of entities			
	Depreciation	Amortisation	Employee benefits	Impairments
Cost of sales (6):	5	4	3	2
Selling, general and administrative expenses (SG&A) (4):	4	4	1	2
Research and development expenses (R&D) (3):	1	3	0	1

Disaggregation of segments into nature expenses or by functions

- C6. The staff analysed the disaggregation of segment expenses. The research shows that:
- (a) 66% disaggregate depreciation and amortisation by segment (31 out of 47 entities);
 - (b) 43% disaggregate impairments by segment (20 out of 47 entities);
 - (c) no entities disaggregate employee benefits by segment; and
 - (d) 11% disaggregate (some) functions by segment (5 out of 47 entities).

Appendix D—FASB project ‘Disaggregation—Income Statement Expenses’

D1. The FASB has decided to restart their disaggregation project ‘Disaggregation—Income Statement Expenses’ (formerly known as ‘Financial Performance Reporting—Disaggregation of Performance Information’¹⁰), partly as a result of the feedback received from the June 2021, Invitation to Comment, Agenda Consultation. This project is in addition to the FASB’s other project on disaggregation ‘Segment Reporting’.

D2. In February 2022, the FASB decided to revise the scope and objective of the project to focus on improving the decision usefulness of entities’ income statements through the disaggregation of:

- (a) selling, general, and administrative expenses;
- (b) cost of services and other cost of revenues; and
- (c) cost of tangible goods sold.

D3. The restarted project is still at an early stage as the FASB has only just decided on a new project objective and started doing research based on the new objective.

¹⁰ The project had been added to the FASB’s technical agenda in 2017.