

STAFF PAPER

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IASB[®] meeting

Project	Primary Financial Statements	
Paper topic	Presentation of operating expenses	
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS[®] Accounting Standards. The IASB's technical decisions are made in public and are reported in IASB[®] Update.

Objective

1. In October 2021, the IASB began its deliberations on the proposals set out in the Exposure Draft *General Presentation and Disclosures* relating to the presentation of operating expenses in the statement of profit or loss.¹ This paper continues those deliberations and asks for the IASB's decisions on whether to confirm, withdraw or revise those proposals.

Summary of staff recommendations

2. The staff recommends that the IASB:
 - (a) expands the explanation in the description of the function of expense method to clarify how this involves allocating and aggregating operating expenses according to the activity to which the consumed economic resource relates (paragraph 15);
 - (b) provides application guidance to clarify the interaction between the function of expense method and the principles of aggregation and disaggregation and the roles of the primary financial statements (paragraph 16);

¹ See October 2021 [Agenda Paper 21B *Analysis of operating expenses—presentation in the statement of profit or loss*](#).

- (c) requires entities to include in cost of sales the carrying amount of inventories recognised as an expense during the period when presenting cost of sales (paragraphs 21–22);
 - (d) requires entities that present functional line items to disclose a narrative description of what types of expenses (based on their nature) are included in each functional line item (paragraph 23).
3. The staff also recommends that the IASB:
- (a) confirms the proposal to require operating expenses to be presented in the statement of profit or loss using a classification based either on their nature or function (paragraph 55(a));
 - (b) confirms the proposal to include application guidance on deciding which method of presenting operating expenses provides the most useful information, including the factors set out in paragraph B45 of the Exposure Draft (paragraph 55(b));
 - (c) withdraw the proposed prohibition on a mixed presentation of operating expenses, and:
 - (i) require entities, when considering which method to use, to consider the roles of primary financial statements (paragraph 52); and
 - (ii) provide examples when a mixed presentation might provide the most useful information (paragraphs 54 and 60);
 - (d) provide application guidance to clarify:
 - (i) the requirement for consistent presentation of operating expenses from one reporting period to the next (paragraph 57); and
 - (ii) how to label nature line items when a mixed presentation is used (paragraph 58).

Introduction and structure of this paper

4. As noted in paragraph 1, the IASB began its deliberations on the proposals set out in the Exposure Draft relating to the presentation of operating expenses in the statement

of profit or loss in October 2021. The IASB considered feedback from respondents and fieldwork participants relating to those proposals. The IASB also discussed:

- (a) the meaning of ‘function’ in the context of the function of expense method and the meaning of ‘cost of sales’; and
- (b) how the IASB should respond to feedback on the proposal to prohibit entities from presenting line items using a mixture of the nature of expense method and the function of expense method (a mixed presentation).

5. The IASB tentatively decided:

- (a) to explore providing limited application guidance on the function of expense method set out in paragraph 70 of the Exposure Draft;
- (b) not to develop a definition of the term ‘cost of sales’ as part of this project;
- (c) to explore providing application guidance to explain that, as a minimum, cost of sales would include inventory expense, calculated in accordance with IAS 2 *Inventories*; and
- (d) to explore:
 - (i) retaining the proposal to require an entity to analyse and present operating expenses in the statement of profit or loss based either on their nature or function;
 - (ii) retaining the proposal to provide application guidance on how to determine which presentation method an entity would use to provide the most useful information to users of financial statements (but modifying that guidance as a consequence of withdrawing the proposal to prohibit a mixed presentation); and
 - (iii) withdrawing the proposed prohibition on a mixed presentation and instead providing application guidance in order to improve comparability and help achieve faithful representation.

6. This paper discusses these matters further, building on the discussion in [Agenda Paper 21B *Analysis of operating expenses—presentation in the statement of profit or loss*](#) from the October 2021 meeting and taking into account comments of IASB members

at that meeting. It includes staff recommendations for modifications and/or additions to the proposals in the Exposure Draft.

7. This paper also considers feedback from respondents on the proposed application guidance in paragraph B45 of the Exposure Draft on how to determine which presentation method would provide the most useful information to users of the entity’s financial statements. That feedback was outlined but not specifically considered at the October 2021 meeting. This paper considers that feedback before considering potential modifications to the proposed application guidance if the IASB agrees to withdraw the proposed prohibition on a mixed presentation.
8. The remainder of this paper is structured as follows:
 - (a) application guidance on the function of expense method (paragraphs 12–24);
 - (b) application guidance on which presentation method provides the most useful information (paragraphs 25–41); and
 - (c) a mixed presentation (paragraphs 42–60).
9. Appendix A of this paper contains an extract from [Agenda Paper 21B *Analysis of operating expenses—presentation in the statement of profit or loss*](#) from the October 2021 meeting, which summarises the feedback from respondents and fieldwork participants relating to the proposed prohibition on a mixed presentation.
10. Appendix B includes illustrations of how requirements and application guidance relating to the function of expense method and a mixed presentation might be worded.
11. Appendix C includes the proposals in paragraph 20 of the Exposure Draft amended by the IASB’s tentative decisions to date relating to the roles of primary financial statements and aggregation and disaggregation principles.

Application guidance on the function of expense method

Applying the function of expense method

12. In October 2021, the IASB discussed feedback from respondents and fieldwork participants that included some requests for a definition of ‘function’ and additional

guidance on applying the function of expense method. The IASB also discussed staff suggestions for additional application guidance that could be provided.²

13. The IASB noted that the function of expense method is not a new method—IAS 1 *Presentation of Financial Statements* requires entities to present an analysis of expenses recognised in profit or loss using either the function of expense method or the nature of expense method.³ IASB members also expressed concerns that some of the staff suggestions for additional application guidance may have unintended consequences. However, they noted that other suggestions may be helpful. Overall, as noted in paragraph 5, the IASB tentatively decided to explore providing limited application guidance on the function of expense method set out in paragraph 70 of the Exposure Draft.
14. Having considered IASB members’ comments on the previous staff suggestions, the staff are recommending some minor clarifications to the proposals in the Exposure Draft to help entities to apply the function of expense method.
15. Firstly, the staff think it would be helpful to clarify the relationship between the function of expense method and expenses of the same nature. Typically, the function of expense method involves allocating operating expenses of the same nature between different types of activities of the entity. For example, employee services are consumed in a range of different types of activities (such as production, sales or research and development). Therefore, applying the function of expense method entails allocating the costs of those employee services to the different types of activities in which those services were consumed. The staff recommend adding such an explanation to the description of the function of expense method. An illustration of how paragraphs 69 and 70 of the Exposure Draft might be worded is included in Appendix B.
16. Secondly, the staff think it would be helpful to clarify the roles of primary financial statements and the aggregation and disaggregation principles in applying the function of expense method, focussing on the need to present an understandable overview of

² See paragraphs 29–39 of October 2021 [Agenda Paper 21B Analysis of operating expenses—presentation in the statement of profit or loss](#) for further information.

³ See paragraph 99 of IAS 1.

operating expenses and aggregating expenses based on shared characteristics.^{4,5} Such application guidance would help to avoid too much or too little aggregation (an illustration of how such application guidance might be worded is included in Appendix B).

17. For example, an entity may have a range of administrative activities (such as human resources, information technology, legal and accounting). To provide an understandable overview of its expenses, the entity may aggregate expenses relating to those activities and present them as an ‘administrative expenses’ functional line item in the statement of profit or loss—the expenses are aggregated because they share the characteristic of being consumed in administrative activities. However, expenses would not be aggregated if doing so would result in the aggregation of expenses with sufficient dissimilar characteristics that their aggregation did not result in an understandable overview of the entity’s expenses. For example, expenses consumed in selling and expenses consumed in administrative activities share the characteristic of being operating expenses of the entity. However, their characteristics of being consumed in selling activities or being consumed in administrative activities might be sufficiently dissimilar to prevent their aggregation providing an understandable overview.

18. In October 2021, the staff also suggested providing application guidance on the attributes of functions, that is, they represent activities of the entity that are on-going and distinguishable from other activities of the entity. However, IASB members expressed concerns about possible unintended consequences of any such guidance. Having considered those comments, the staff do not recommend pursuing this suggestion further.

⁴ In April 2021, the IASB tentatively decided to include a reference to understandability in the description of the roles of the primary financial statements. See [Agenda Paper 21A Principles of aggregation and disaggregation and roles of the primary financial statements and the notes](#) from that meeting for more information.

⁵ Appendix C includes the proposals in paragraph 20 of the Exposure Draft amended by the IASB’s tentative decisions to date relating to the roles of primary financial statements and aggregation and disaggregation principles.

Cost of sales

19. In October 2021, the IASB discussed a request from some respondents and fieldwork participants for a definition of cost of sales. The staff noted that cost of sales is a key line item when operating expenses are presented by function and feedback from respondents indicates that diversity in practice exists on what it includes. However, in the staff view, it would be difficult to develop a definition of cost of sales within a reasonable timeframe and undertaking such work would delay completion of the project.
20. As noted in paragraph 5, the IASB tentatively decided not to define cost of sales as part of this project. However, the IASB also tentatively decided to explore providing application guidance to explain that cost of sales includes inventory expense, calculated in accordance with IAS 2.
21. In the staff view, it would be helpful to add application guidance on this point. Although it might seem to be stating the obvious, the staff notes that, in practice, some entities exclude components of inventory expense when presenting cost of sales. Therefore, requiring entities to include in cost of sales the amount of inventory expense recognised for the period would help enhance comparability between entities that present cost of sales. In the staff view, such a requirement would not be costly for entities to apply, given that IAS 2 requires entities to:
- (a) recognise the carrying amount of inventories as an expense in the period in which the related revenue is recognised; and
 - (b) disclose the amount recognised as an expense during the period.⁶
22. The staff also considered whether to recommend another requirement for entities to include in cost of sales those costs that are directly related to an entity's production or other revenue generating activities. Such a requirement would not entail providing a definition of cost of sales (consistent with the IASB's tentative decision not to develop such a definition) but would help to ensure that cost of sales includes direct costs, particularly for entities that do not have inventories (such as some service entities). However, adding such a requirement could raise other questions or have

⁶ See paragraphs 34 and 36(d) of IAS 2.

unintended consequences. For example, questions might arise about the distinction between direct and indirect costs. Also, it could imply that cost of sales should not include indirect costs, which would be inconsistent with the requirements of IAS 2 relating to the cost of inventories (for example, see paragraph 12 of IAS 2). Therefore, the staff are not recommending adding such a requirement.

Narrative description of the composition of functions

23. In October 2021, the staff recommended exploring a requirement for entities that present functional line items to disclose a narrative description of what types of expenses (based on their nature) are included in each functional line item, such as what types of expenses are included in cost of sales. This disclosure would help users understand what functional line items comprise. For example, it would help users to assess the extent of comparability between entities when cost of sales is presented. The staff continue to recommend adding such a requirement.⁷

24. The staff are not recommending adding a similar requirement for entities applying the nature of expense method to provide a narrative description of what types of expenses are included in nature line items. In the staff view, such a requirement is unnecessary, because typically it is clear what types of expenses are included in nature line items (except for ‘other’ expenses, for which the Exposure Draft proposed specific requirements).

⁷ This requirement would be in addition to the requirement to disclose, for depreciation, amortisation and employee benefits, the amounts included in each line item (IASB tentative decision in July 2022).

Questions for the IASB

Q1. Does the IASB agree to:

- (a) expand the explanation in the description of the function of expense method to clarify how this involves allocating and aggregating operating expenses according to the activity to which the consumed economic resource relates (paragraph 15);
- (b) provide application guidance to clarify the interaction between the function of expense method and the principles of aggregation and disaggregation and the roles of primary financial statements (paragraph 16);
- (c) require entities to include in cost of sales the carrying amount of inventories recognised as an expense during the period when presenting cost of sales (paragraphs 21–22); and
- (d) require entities that present functional line items to disclose a narrative description of what types of expenses (based on their nature) are included in each functional line item (paragraph 23)?

Application guidance on which presentation method provides the most useful information

Feedback received on the proposed application guidance

25. Paragraph B45 of the Exposure Draft proposed application guidance that an entity would be required to consider when deciding which method of analysing and presenting operating expenses provides the most useful information, as follows:

B45 Paragraph 68 requires an entity to present an analysis of expenses classified in the operating category using either the nature of expense method or the function of expense method, whichever provides the most useful information. An entity shall consider, in deciding which method of expense analysis provides the most useful information:

- (a) which method provides the most useful information to users of financial statements about the key components or drivers of the entity's profitability. For example, for a retail entity a key component or driver of profitability could be cost of sales. Presenting a cost of sales line item can provide relevant information about whether the revenue generated from the sale of goods covers what, for retailers, are mainly direct costs, and by what margin. However, cost of sales is unlikely to provide relevant information about the key components or drivers of profitability when the link between revenue and costs is less direct. For example, for a service entity, information about the expenses presented using a nature of expense analysis, such as employment costs, may be more relevant to users.
- (b) which method most closely represents the way the business is managed and how management reports internally. For example, a manufacturing entity managed on the basis of major functions might use a function of expense method for internal reporting. However, an entity that has a single predominant function, such as a financing activity, may find a more detailed analysis of expenses using a nature of expense method provides more useful information.
- (c) industry practice. The use of similar methods for an analysis of expenses would enable users to more easily compare expenses across entities in the same industry.
- (d) whether the allocation of expenses to functions would be arbitrary and therefore would not provide a sufficiently faithful representation of the line items presented. In such cases, the nature of expense method shall be used.

26. Many respondents did not comment on the proposed application guidance in paragraph B45 of the Exposure Draft. Of those respondents who commented on the proposed application guidance, most agreed with that guidance. Some provided more detailed comments and said that the following factors included in the application guidance were helpful for determining which method is the most useful:

- (a) the way the business is managed and how management reports internally; and
- (b) industry practice, which will lead to increased comparability among entities in the same sector.

27. Some of these respondents, including a regulator and an accounting firm, however, suggested that the IASB provide further examples and guidance to improve the enforceability of this requirement and reduce diversity in application.
28. Some respondents disagreed with the application guidance. Many of those respondents disagreed with the inclusion of any such guidance in the [draft] IFRS Accounting Standard because, in their view:
- (a) management should determine which presentation method should be used (that is, management should have a free choice); and/or
 - (b) the IASB should retain the current requirement in IAS 1, whereby an entity is required to use whichever method of analysis provides information that is reliable and more relevant.⁸
29. Other reasons for disagreeing with the application guidance included:
- (a) the factors in B45(a) (key drivers of profitability) and B45(b) (the way business is managed) are, in their view, neither supporting the nature of expense nor the function of expense method, as internal reports and communication to investors focus on income and profit rather than expenses. Therefore, in practice, paragraph B45(c) (industry practice) is expected to be the predominant factor.
 - (b) significant judgement will be involved in applying this guidance and entities might be able to support either presentation by nature or by function, which could result in diversity in practice, even between entities in the same industry.
 - (c) allocation of expenses to functions is arbitrary, in the view of a few preparers, because IFRS Accounting Standards do not provide sufficient guidance. Therefore, they said that application of paragraph B45(d) could always result in presentation of expenses by nature.

⁸ Respondents who expressed these views were mainly preparers, together with an accounting firm, an accountancy body and two standard-setting bodies.

- (d) the proposals do not provide guidance for situations where one or more factors support the nature of expense method, but other factors support the function of expense method.

Staff analysis

30. The staff first considered the more general question of whether the IASB should confirm its proposal to provide application guidance to assist an entity to determine which presentation method should be used.
31. In the staff view the IASB should confirm its proposal to provide application guidance because retaining the current requirement of IAS 1 or providing entities with a free choice would not be consistent with the IASB's objective of strengthening IAS 1. Also, in the staff view, the feedback does not provide a compelling reason not to proceed with the proposal to provide application guidance on this matter.
32. The staff next considered the more specific question of whether the IASB should confirm all of the factors set out in paragraph B45 of the Exposure Draft.
33. The staff acknowledges that, as noted by some respondents, applying those factors may result in entities within the same industry using a different presentation method. However, in the staff view, such an outcome does not mean that the factors in paragraph B45 of the Exposure Draft are inappropriate. Paragraph 68 of the Exposure Draft proposes to require an entity to use whichever presentation method provides the most *useful* information. Comparability between entities is an important, but not the only, qualitative characteristic of useful information, as discussed in the *Conceptual Framework for Financial Reporting*. In particular, the factors in paragraph B45 of the Exposure Draft also reflect the qualitative characteristics of relevance and faithful representation, in addition to comparability. Therefore, in the staff view, the factors provide an appropriate balance of the qualitative characteristics of useful information.
34. Considering the feedback from respondents, the staff did not identify a reason to remove any of the proposed factors (or add any factors). In the staff view, all factors would assist preparers with determining which presentation method would provide the most useful information. For example, the first two factors in paragraph B45 of the Exposure Draft—about the key components or drivers of profitability and how the

business is managed and reports internally—are focused on relevance. Feedback indicates that the second factor may be more helpful than the first factor (see paragraph 26(a)). However, the first factor focuses on the objective of selecting the presentation method that provides the most useful information to users of the entity’s financial statements, so the staff think it should be retained.

35. In many cases, these two factors are likely to be complementary. For example, if cost of sales is a key component or driver of profitability, it is also likely that operating expenses relating to cost of sales will be managed and reported internally by function. The staff therefore considered whether the application guidance could be simplified by removing the second factor. However, given the feedback on how helpful it is, on balance, the staff think that both factors should be confirmed.
36. The third factor would require entities to consider industry practice. This factor would be particularly helpful for entities operating in an industry in which a particular presentation method is commonly used. As noted in the Exposure Draft and in feedback from respondents (see paragraph 26(b)), requiring an entity to consider this factor would help to improve comparability between entities in the same sector.
37. The fourth factor would require entities to consider whether allocation of expenses to functions would be arbitrary and therefore would not provide a faithful representation of the line items presented. As noted in paragraph 29(c), a few preparers disagreed with this factor because, in their view, IFRS Accounting Standards do not provide sufficient guidance on the allocation of expenses to functions, which could lead to entities always presenting expenses by nature. In the staff view, such an outcome is very unlikely. Although there are situations in which the allocation of expenses to functions may be arbitrary that does not mean that the allocation of expenses to functions is *always* or *generally* arbitrary. In practice, many entities use the function of expense method, for both internal and external reporting purposes, notwithstanding that IAS 1 does not provide application guidance on allocating expenses to functions. The staff thinks that such common practice would not have evolved if the allocation of expenses to functions is always or generally arbitrary.
38. Furthermore, the IASB tentatively agreed in October 2021 to explore withdrawing the proposed prohibition on a mixed presentation (as discussed further in paragraphs 42–60). If a mixed presentation is permitted, then if the allocation of particular types of

expenses to functions is arbitrary (such as goodwill impairment), applying the fourth factor would indicate that those particular expenses should be presented by nature—the entity would not need to apply the nature of expense method to all operating expenses simply because the allocation of some particular expenses to functions may be arbitrary. Permitting a mixed presentation may also assist in other situations in which application of the factors proposed in paragraph B45 of the Exposure Draft does not clearly indicate whether the function of expense method or the nature of expense method should be used—in some cases, such a situation could arise because a mixed presentation may provide the most useful information.

39. The IASB also tentatively decided to explore providing limited application guidance on the function of expense method set out in paragraph 70 of the Exposure Draft (as previously discussed in paragraphs 12–24). In the staff view, any such guidance would also assist preparers with applying the proposed guidance in paragraph B45 of the Exposure Draft.
40. The staff thinks that it is not necessary—and may be unhelpful—to develop additional application guidance on determining which presentation method provides the most useful information. In the staff view, applying the proposed factors and deciding which presentation method would provide the most useful information would depend on the specific facts and circumstances of each entity. Hence, developing additional application guidance would risk developing requirements that may be overly prescriptive or not operable in practice.
41. In summary, in the staff view, the IASB should confirm the application guidance proposed in paragraph B45 of the Exposure Draft but not add additional factors to consider. However, some additional application guidance may be required if the IASB decides to withdraw the proposed prohibition on a mixed presentation, which is discussed in paragraphs 42–60.

Mixed presentation

42. In October 2021, the IASB discussed feedback from respondents and fieldwork participants on the proposed prohibition on a mixed presentation (see Appendix A for more information). The IASB also discussed a staff analysis of that feedback,

including whether the IASB should proceed with the proposed prohibition and, if not, an alternative approach.⁹ The IASB decided to explore an alternative approach suggested by staff that would aim to strengthen the requirements of IAS 1, consistent with the overall objective of the proposals in the Exposure Draft on this topic, but in a way that avoids a loss of relevant information. More specifically, the staff suggested an approach that would:

- (a) retain the proposal to require operating expenses to be analysed and presented in the statement of profit or loss based either on their nature or function, rather than based on some other characteristic. This point would strengthen IAS 1, which encourages, but does not require, an analysis of operating expenses by nature or function to be presented in the statement of profit or loss.
- (b) not retain the proposed prohibition on a mixed presentation. This point would help to address concerns raised by many respondents, for example, about a loss of relevant information if a mixed presentation is prohibited.¹⁰ It also helps to address the limitations of any application guidance on presenting operating expenses by function.¹¹ Instead, additional application guidance would be provided to help improve comparability and help achieve faithful representation.
- (c) retain the proposal to provide application guidance on how to determine which presentation method should be used to provide the most useful information to users of the financial statements. As noted in paragraph 31, providing that guidance would strengthen IAS 1, which contains little guidance on determining which presentation method provides the most useful information. However, some modifications to the proposed application guidance would be necessary as a consequence of withdrawing the prohibition on a mixed presentation.

⁹ See paragraphs 43–56 of October 2021 [Agenda Paper 21B Analysis of operating expenses—presentation in the statement of profit or loss](#) for more information.

¹⁰ See Appendix A for more information.

¹¹ See paragraph 38 of October 2021 [Agenda Paper 21B Analysis of operating expenses—presentation in the statement of profit or loss](#) for more information.

43. The staff continue to recommend this approach and have developed it further, as discussed in paragraphs 44–60.

Modifications to paragraph 68 of the Exposure Draft and the related application guidance

44. Paragraph 68 of the Exposure Draft proposed requiring an entity to present 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, whichever provides the most useful information. As part of the related application guidance, paragraph B46 of the Exposure Draft proposed that entities must not provide an analysis of operating expenses using a mixture of the nature of expense method and function of expense method (a mixed presentation). Hence, the intention was that entities would select one method that would apply to all operating expenses, except when necessary to present required line items (see paragraph B47 of the Exposure Draft). The staff considered how the proposals in the Exposure Draft should be modified, if the IASB agrees to withdraw the proposed prohibition on a mixed presentation (an illustration of how such modifications might be worded is included in Appendix B).

Should entities be required to select a ‘main’ or ‘predominant’ method?

45. The staff first considered whether entities should still be required to select a ‘main’ or ‘predominant’ method of presenting operating expenses—either the nature of expense method or the function of expense method—with the second method used on an exception basis. For example, an entity might present operating expenses mainly by function, with a few expenses presented by nature.
46. In considering whether to require a ‘main’ method of presenting operating expenses, it should be noted that some mixing of the methods is likely inevitable, particularly when applying the function of expense method. For example, some required line items are expenses by nature. Also, some types of operating expenses may be difficult to allocate to functions in a non-arbitrary way, such as goodwill impairment and foreign exchange differences. The latter issue may arise more frequently in the future because the aggregation and disaggregation principles may result in the presentation of more functions, thereby requiring more allocation.

47. In current practice, some entities present a highly aggregated line item for ‘selling, general and administrative expenses’, which is typically a residual line item that includes all operating expenses other than those included in cost of sales. When preparing the entity’s financial statements, such a highly aggregated line item requires little allocation of expenses to functions. However, applying the aggregation and disaggregation principles (see paragraph 16–17), an entity might conclude that it should disaggregate ‘selling, general and administrative expenses’ into several functions.

48. That greater disaggregation likely would provide more useful information to users of the entity’s financial statements. However, it is also more likely that some expenses may need to be presented separately by nature, because it would be arbitrary to allocate them across the now disaggregated functions.

49. More generally, in the staff view, requiring entities to select a ‘main’ method would be difficult to operationalise. For example, one question is whether the ‘main’ method should be determined by the number of functional line items compared with the number of nature line items. Or whether it should be determined by the proportion of total expenses presented by function compared with the proportion presented by nature. If the latter approach was used, related questions include determining what should be the specified proportion of expenses and what would be the implications if a line item presented using the ‘secondary’ method included an unusually large expense in a particular period. Addressing these issues is likely to be difficult and time-consuming.

50. Furthermore, in the staff view, such an approach seems inconsistent with another of the reasons for withdrawing the prohibition on a mixed presentation, which relates to respondents’ concerns about a loss of relevant information (see paragraph 42(b) and Appendix A). For some entities, a mixed presentation may provide the most useful information to users of their financial statements. For example, an entity with two different types of main business activities might present some of its expenses by function and other expenses by nature, to provide information about the key drivers of its profitability, without either method necessarily being the ‘main’ method.

51. In summary, the staff view is that the IASB should not modify the requirements in paragraph 68 of the Exposure Draft and the related application guidance to include a

requirement for entities to select a ‘main’ method of presenting operating expenses. Instead, an entity would consider the factors set out in paragraph B45 of the Exposure Draft to determine which method to use when aggregating expenses into either functional or nature line items.

Interaction with the roles of primary financial statements

52. Although the staff does not recommend requiring that an entity select a ‘main’ method of presenting operating expenses, the overriding consideration would remain—that is, the entity would consider which method to use so as to provide the most useful information about operating expenses presented in the statement of profit or loss to users of its financial statements. To reinforce that point, and to more clearly link the requirements on presenting operating expenses with the role of the primary financial statements, the staff recommend adding to the application guidance a specific requirement to consider the roles of the statement of profit or loss (an illustration of how such application guidance might be worded is included in Appendix B; Appendix C includes the proposals in paragraph 20 of the Exposure Draft amended by the IASB’s tentative decisions to date relating to the roles of primary financial statements and aggregation and disaggregation principles).
53. Specifically requiring entities to consider the roles of the statement of profit or loss would serve as a reminder for entities to consider, for example, how to present operating expenses so as to provide an understandable overview of those expenses—which is likely to be particularly important for entities contemplating using a mixed presentation. It would also remind entities to consider whether specific expense items should be presented separately in the statement of profit or loss so as to help users to identify items about which they may wish to seek additional information in the notes—such as impairment expense and other items that paragraph B15 of the Exposure Draft lists as examples of circumstances that could give rise to separate presentation in the statement of profit or loss.

Examples when mixed presentation might provide the most useful information

54. The staff recommend the IASB provide examples of when a mixed presentation might provide the most useful information. For example, the factors in paragraphs B45(a)–(c) may indicate use of the function of expense method, except for specific expenses

for which the allocation to functions would be arbitrary. Another example is an entity that has two different types of main business activities. To provide information about the key drivers of its profitability, such an entity may present some of its expenses using the function of expense method and other expenses using the nature of expense method (an illustration of how such application guidance might be worded is included in Appendix B).

55. When considering the recommended modifications, it should be borne in mind that the other key elements of the proposals in the Exposure Draft would remain—as discussed in paragraph 41, even if the IASB withdraws the prohibition on a mixed presentation, it would nevertheless:
- (a) retain the proposal to require operating expenses to be aggregated and presented in the statement of profit or loss based either on their nature or function, rather than based on some other characteristic. As noted in paragraph 42(a), this point would strengthen IAS 1, which has few specific requirements on presenting operating expenses in the statement of profit or loss—it encourages, but does not require, an analysis of operating expenses by nature or function to be presented in the statement of profit or loss.
 - (b) retain the proposal to provide application guidance on how to determine which presentation method should be used to provide the most useful information to users of the financial statements. As noted in paragraphs 31 and 42(c), providing that guidance would strengthen IAS 1, which contains little guidance on determining which presentation method provides the most useful information.

Additional application guidance if a mixed presentation is permitted

56. As noted in paragraph 42(b), the staff’s suggested approach discussed in October 2021 includes providing additional application guidance if a mixed presentation is permitted, to improve comparability and help achieve faithful representation.

Consistency of presentation method

57. The staff recommend adding application guidance on the consistency of the presentation method used from one reporting period to the next, to address concerns that permitting a mixed presentation may provide more scope for entities to change their presentation from period to period. This would help comparability, which was one of the key objectives of the IASB’s work on the statement of profit or loss in this project. This application guidance would be based on the general requirement in paragraph 33 of the Exposure Draft (and paragraph 45 of IAS 1) on consistency of presentation. Hence, this application guidance would not constitute an additional requirement. However, it would serve as a reminder of that general requirement, to aid comparability over time. Although the staff recommendation is prompted by considering entities that use a mixed presentation, it would apply to all entities, not only those that use a mixed presentation.

Labelling of nature line items

58. The staff recommend adding application guidance on the labelling of nature line items when using a mixed presentation. When using a mixed presentation, a portion of some nature line items may be allocated to functional line items. The guidance would require entities to consider how to describe those nature line items using labels that faithfully represent the characteristics of the expenses included in those line items. For example, a line item should not be described as ‘impairment’ if that line item is not complete because a portion of impairment (for example relating to property, plant and equipment) has been allocated to functional line items. Instead, the entity could use a more accurate label, for example ‘impairment of goodwill’. This point is based on the general presentation requirement in paragraph 26 of the Exposure Draft on describing items presented or disclosed in the financial statements. Hence, this application guidance would not constitute an additional requirement. However, it would serve as a reminder of that general requirement, to help achieve faithful representation. This will also help avoid making expenses that are not comparable look comparable.

Other potential guidance

59. The staff previously suggested adding application guidance to require functional line items, including cost of sales, to be complete, meaning that all costs relating to a

particular function must be included in the applicable functional line item rather than presenting some of those costs separately by nature. The completeness of a functional line item would be based on the entity's description of its method of aggregating operating expenses when presenting that functional line item and any specific guidance in the IFRS Accounting Standard on cost of sales (as discussed in paragraphs 19–22). However, on further reflection, the staff are not recommending developing this suggestion further. It seems unlikely that any such application guidance would have any effect in practice, given that entities largely determine for themselves which costs to include in functional line items when applying the function of expense method.¹²

60. Instead, the IASB could provide an example of when mixed presentation may not result in the most useful information being provided. For example, if an entity presents a functional line item but excludes from this line item, and separately presents, an expense by nature that is directly related to the function.

¹² Except for the proposed requirement to include inventory expense in cost of sales, if the IASB agrees to the staff recommendation on that point.

Questions for the IASB

Q3. Does the IASB agree to:

- (a) confirm the proposals to:
 - (i) require operating expenses to be presented in the statement of profit or loss using a classification based either on their nature or function (paragraph 55(a)); and
 - (ii) include application guidance on deciding which method of presenting operating expenses provides the most useful information, including the factors set out in paragraph B45 of the Exposure Draft (paragraph 55(b));
- (b) withdraw the proposed prohibition on a mixed presentation of operating expenses, and:
 - (i) require entities, when considering which method to use, to consider the roles of primary financial statements (paragraph 52); and
 - (ii) provide examples when a mixed presentation might provide the most useful information (paragraphs 54 and 60);
- (c) provide application guidance to clarify:
 - (i) the requirement for consistent presentation of operating expenses from one reporting period to the next (paragraph 57); and
 - (ii) how to label nature line items when a mixed presentation is used (paragraph 58)?

Appendix A—Extract from October 2021 Agenda Paper 21B *Analysis of operating expenses—presentation in the statement of profit or loss****Prohibition on mixing the methods***

- A1. Respondents expressed mixed views on the proposed prohibition on a mixed method of presentation. Many respondents, mainly users, accountancy bodies and standard-setters, agreed with the proposed requirement that an entity should not provide an analysis of expenses classified in the operating category using a mixture of the nature of expense method and the function of expense method. Their reasons included that the proposed requirements would enhance comparability, both from period to period for a reporting entity and in a single period across entities, and that the prohibition on mixing the methods may help users make forecasts.
- A2. Many respondents, mainly preparers and their representative bodies along with a few users, disagreed with the Board's proposed requirement that an entity should not provide an analysis of operating expenses using a mixture of both methods. Their comments include:
- (a) the mixed method provides the most useful information to users and should be allowed. For example, entities may have multiple business activities, and the method most useful for one may not be the method most useful for the other.
 - (b) the mixed method is common for entities operating in the real estate, mining, hospitality, and oil and gas industries. They have not heard questions or concerns from users of their financial statements regarding their mixed presentation of operating expenses.
 - (c) the proposed requirements will not enhance comparability, especially with companies applying US GAAP.
 - (d) not mixing the two methods would result in high costs, because it would require a change in systems.
- A3. Some respondents also made comments about the interaction between the prohibition of a mixed presentation and the proposed requirement to disclose minimum line items (paragraph 65 of the Exposure Draft), regardless of the method of analysis of expenses used, including:

- (a) some of the line items are expenses by nature (for example, impairment losses determined in accordance with IFRS 9 *Financial Instruments*), and some of them are expenses by function (for example, insurance service expenses from contracts in the scope of IFRS 17 *Insurance Contracts*). Therefore, some entities will inevitably use a mixed presentation.
 - (b) paragraph 65(a)(vii) could be read as requiring presentation of cost of sales even when a by-nature analysis of expenses is presented.
 - (c) paragraph 65 is an ad hoc collection of line items that have accumulated over the years through new and revised IFRS Standards, not necessarily prepared on the same basis. For example, respondents questioned why impairment losses related to financial assets (a required line item) deserve more prominence than impairment losses related to non-financial assets (not a required line item).
- A4. Some respondents commented that it was unclear how the proposed paragraph B15, which lists circumstances that would give rise to the separate presentation of other income and expense items in the statement of profit or loss or in the notes, linked with the proposed prohibition on a mixed presentation.
- A5. Some respondents also provided suggestions about a mixed presentation method, including that the Board should:
- (a) undertake further research to establish the prevalence of the mixed method and why entities consider that such a method provides the most useful information.
 - (b) permit limited mixing of method, to enable those entities using a functional analysis to present separately specific items analysed by nature, for example, amortisation, depreciation and impairment.
 - (c) require separate presentation of particular line items, when an entity presents its operating expenses by function, for example:
 - (i) impairment of goodwill, because it is difficult to allocate to functions; and
 - (ii) restructuring, because it includes an allocation of items of a different nature (such as employee benefits, impairment of assets, gains or losses)

on disposal of assets) and is sufficiently different from other functions to warrant separate presentation.

- A6. Some respondents suggested that the Board should define nature of expense and function of expense. In particular, the respondents asked for:
- (a) a definition of a function;
 - (b) guidance for allocation of expenses to functions; and
 - (c) a specific definition of cost of sales.
- A7. A few respondents, including a few users, said that an entity using the by-function method should disclose the definition of its functions and the nature of expenses that contribute to these functions.

Fieldwork findings

- A8. An analysis of the financial statements of the 49 participants in the fieldwork found that they present expenses as follows:
- (a) twenty-five presented expenses by function;
 - (b) seventeen presented expenses by nature; and
 - (c) seven presented expenses using a mixed method, with line items presented by functions but also presenting other separate line items, including those for:
 - (i) impairment of property, plant and equipment (three participants);
 - (ii) impairment of goodwill (one participant);
 - (iii) disposal gains and losses (four participants);
 - (iv) changes in fair value of investment properties (three participants);
 - (v) foreign exchange differences (two participants); and
 - (vi) amortisation of intangible assets (one participant).
- A9. Some participants that presented an analysis of expenses by function raised concerns that some information about expenses that would be useful, such as gains or losses on disposals, would have to be included in the notes instead of in the statement of profit or loss. Some participants said presenting an analysis of expenses that does not mix

the nature of expense and function of expense methods and requires the presentation that is most useful may conflict with local regulation.

A10. Some participants that originally presented the analysis of expenses using a mixture of the nature of expense method and the function of expense method said it was challenging, or they were unclear on how, to allocate some expenses to functional line items, such as foreign exchange differences, goodwill impairment, restructuring and donations. Some of these participants presented line items labelled ‘restructuring’ or ‘other’ to present these expenses but were unclear whether these line items would be consistent with the description of the function of expense method. More generally, some participants said that it was not clear how to apply the function of expense method because:

- (a) in their view, there is no clear definition of the method or underlying principle;
- (b) there is no guidance on when and how to allocate expenses to functional line items;
- (c) there is no guidance on what expenses may or may not be aggregated to form functional line items; and
- (d) there are no minimum line items by function other than cost of sales and the contents of cost of sales is not defined.

A11. Other aspects of the proposals that participants found unclear included:

- (a) which method to use for presenting expenses in the statement of profit or loss when there were multiple main business activities for which the most useful method of presentation would be different;
- (b) whether aggregating line items using the nature of expense method and using a label for that line item such as ‘general and administrative expenses’ constituted a function and would therefore be prohibited as a mixed presentation;
- (c) whether line items described as benefiting from disaggregation (paragraph B15 of the Exposure Draft) can be presented separately regardless of the method of analysis of expenses used or should be allocated by functions;

- (d) whether minimum line items are always required, even if presenting expenses using the function of expense method; and
- (e) whether cost of sales is only a minimum line item when presenting expenses using the function of expense method.

Appendix B—Illustrations of how requirements and application guidance relating to the function of expense method and a mixed presentation might be worded

Illustration of how paragraphs 69 and 70 of the Exposure Draft might be worded (paragraphs 14–15 of this paper)

- 69 The nature of expense method provides information about operating expenses based on the nature of the economic resources arising from the inputs that are consumed to accomplish an entity’s activities—such as information about ~~expenses related to materials~~ (raw materials, ~~employee services~~~~employees~~ (employee benefits), equipment (depreciation) or intangible assets (amortisation)) consumed—without reference to ~~how expenses are allocated to the activities~~~~functions within the business~~ within which those economic resources were consumed.
- 70 The function of expense method allocates and aggregates operating expenses according to the activity to which the ~~item~~ consumed economic resource relates. For example, cost of sales is a functional line item that combines expenses that relate to an entity’s production or other revenue generating activities such as: raw materials, employee benefit expense, depreciation or amortisation. Hence, when applying the function of expense method, expenses relating to economic resources of the same nature (such as employee services) may be allocated to several functional line items (such as cost of sales and research and development).

Illustration of how the application guidance might be worded (paragraphs 14 and 16–17 of this paper)¹³

The entity shall consider how to aggregate expenses relating to the activities of the entity so as to provide an understandable overview of its expenses in the statement of profit or loss (see paragraph 20(a)). For example, an entity may have a range of administrative activities (such as human resources, information technology, legal and accounting). To provide an understandable overview of its expenses, the entity may aggregate expenses relating to those activities and present them as an ‘administrative expenses’ functional line item in the statement of profit or loss. Such an aggregation is based on the shared characteristic of the expenses of being consumed in administrative activities (see paragraph 25(a)). However, expenses are not aggregated

¹³ The paragraphs in this illustration refer to paragraphs in the Exposure Draft.

if they have sufficient dissimilar characteristics that the aggregation does not result in an understandable overview of the entity's expenses. For example, expenses consumed in selling and expenses consumed in administrative activities share the characteristic of being operating expenses of the entity. However, their characteristics of being consumed in selling activities or being consumed in administrative activities might be sufficiently dissimilar to prevent their aggregation providing an understandable overview.

Illustration of how paragraph 68 of the Exposure Draft and related application guidance might be worded (paragraphs 44–55 of this paper)

68 [IAS 1.99] An entity shall present expenses in the operating category of the statement of profit or loss ~~that are aggregated~~ ~~an analysis of expenses~~ using a classification based on either their nature—the nature of expense method—or their function within the entity—the function of expense method. The entity shall aggregate expenses and present line items ~~the analysis~~ using whichever ~~the~~ method ~~that~~ provides the most useful information to users of their financial statements (see paragraphs B45–B47).

...

Presentation ~~Analysis~~ of expenses classified in the operating category

B45 Paragraph 68 requires an entity to present ~~an analysis of~~ expenses classified in the operating category that are aggregated using either the nature of expense method or the function of expense method, whichever provides the most useful information. An entity shall consider the role of the statement of profit or loss (see paragraph 20) in deciding which method of presenting line items for expenses ~~expense~~ classified in the operating category ~~analysis~~ provides the most useful information. For example, an entity considers how to present expenses classified in the operating category so as to provide an understandable overview of those expenses. An entity shall also consider:

- (a) which method provides the most useful information to users of financial statements about the key components or drivers of the entity's profitability. For example, for a retail entity a key component or driver of profitability could be cost of sales. Presenting a cost of sales line item can provide relevant information about whether the revenue generated from the sale of goods covers what, for retailers, are mainly direct costs, and by what margin. However, cost of sales is unlikely to provide relevant information about the key components or drivers of profitability when the link between revenue and costs is less direct. For example, for a service entity,

information about the expenses presented using the nature of expense ~~method~~analysis, such as employment costs, may be more relevant to users.

- (b) which method most closely represents the way the business is managed and how management reports internally. For example, a manufacturing entity managed on the basis of major functions might use a function of expense method for internal reporting. However, an entity that has a single predominant function, such as a financing activity, may find ~~a more detailed analysis of expenses~~ using the nature of expense method provides more useful information.
- (c) industry practice. The use of similar methods for aggregating and presenting an analysis of expenses would enable users to more easily compare expenses across entities in the same industry.
- (d) whether the allocation of expenses to functions would be arbitrary and therefore would not provide a sufficiently faithful representation of the line items presented. Any such expenses shall be aggregated and presented using the nature of expense method ~~shall be used~~.

B46 ~~An entity shall not provide an analysis of expenses classified in the operating category using a mixture of the nature of expense method and the function of expense method except when required to do so by paragraph B47.~~ In some cases, when an entity considers the factors set out in paragraphs B45(a)–(d), it may decide that aggregating and presenting some expenses using the nature of expense method and other expenses using the function of expense method (a mixed presentation) would provide the most useful information. For example, considering the factors in paragraphs B45(a)–(c) may indicate use of the function of expense method, except for specific expenses for which the allocation to functions would be arbitrary (see paragraph B45(d)). Another example is an entity that has two different types of main business activities. To provide information about the key drivers of its profitability, such an entity may present some of its expenses using the function of expense method and other expenses using the nature of expense method.

B47 An entity shall present in the statement of profit or loss the line items required by paragraph 65 regardless of the method used to aggregate and present of ~~analysis of expenses used.~~^[14] In addition to those required line items, the entity

¹⁴ The preliminary draft of proposed modifications to the application guidance illustrated in this paper relate only to matters addressed in this paper. Other modifications to paragraph B47 of the Exposure Draft are also

shall consider whether to present separately in the statement of profit or loss some other specific expense items so as to help users of its financial statements to identify items about which they may wish to seek additional information in the notes (see paragraphs 20(c) and B15).

Illustration of recommended additional application guidance if a mixed presentation is permitted (paragraphs 56–60 of this paper)

- (a) A change in mixed presentation is a change in accounting policy as described in paragraph 33(a). For example, if an entity presents impairment of goodwill as a nature line item in one reporting period it shall also present any subsequent impairment of goodwill as a nature line item unless paragraph 33(a) or 33(b) applies. If there is no impairment of goodwill in a subsequent reporting period resulting in no amount being presented separately, that is not a change in accounting policy.
- (b) If an entity applies the nature of expense method to only some of its expenses (that is, a mixed presentation (see paragraph B46)), those nature line items may include expenses of which a portion has been allocated to functional line items. In accordance with paragraph 26, the entity shall consider how to describe those nature line items using labels that faithfully represent the characteristics of those expense items. For example, labelling a line item as ‘depreciation’ would not faithfully represent the characteristics of the expense items included in that line item if a portion of depreciation expense has been allocated to functional line items. An alternative would be to use a more descriptive label (such as ‘depreciation of office buildings’).

likely to be necessary to implement the IASB’s tentative decisions in February 2022 relating to required line items. See [IFRS - IASB Update February 2022](#) for more information.

Appendix C—Proposals in the Exposure Draft amended by the IASB’s tentative decisions to date relating to the roles of primary financial statements and aggregation and disaggregation principles

- 20 The role of the primary financial statements is to provide a structured ~~and comparable~~ summary of a reporting entity’s recognised assets, liabilities, equity, income, expenses and cash flows, which is useful for:
- (a) obtaining an understandable overview of the entity’s assets, liabilities, equity, income, expenses and cash flows;
 - (b) making comparisons between entities, and between reporting periods for the same entity; and
 - (c) identifying items or areas about which users of financial statements may wish to seek additional information in the notes.