

Primary Financial Statements Operating expenses

Joint CMAC-GPF meeting
Agenda Paper 2
June 2022

Purpose of this session

- The purpose of this session is to obtain feedback from CMAC and GPF members to help the IASB's future discussions on the disclosure of operating expenses by nature in the notes
- In this session, we will:
 - give CMAC and GPF members an update on the IASB's redeliberations on the proposal in paragraph 72 of the Exposure Draft – which requires that an entity that reports expenses by function in the statement of profit or loss discloses in the notes an analysis of its total operating expenses by nature (slides 4–6);
 - discuss staff analysis on this topic including examples (slides 7–13); and
 - ask CMAC and GPF members to discuss questions in the breakout sessions – some questions are specific to CMAC or GPF members and other questions are for both (slides 14–15).

Agenda

Background (slides 4–6)

Which expenses to include in the analysis? (slides 7–9)

What should the analysis relate to? (slides 10–13)

Questions for discussion in the breakout sessions (slides 14–15)

Appendix–Summary of October 2021 and April 2022 IASB meetings (slide 17)

Appendix–Illustration of Exposure Draft proposal (slide 18)

Operating expenses: Background (1)

- The proposal in paragraph 72 of the ED requires that an entity reporting expenses by function in the statement of profit or loss disclose in the notes an analysis of its total operating expenses by nature (see illustration of disclosure requirement on slide 18)
- The IASB received mixed feedback on the proposal, in particular:
 - many respondents (mainly users, standard-setters and accountancy bodies) agreed with the proposal because it would:
 - enable a comparison with information provided in the statement of cash flows; and
 - help forecast future operating expenses and cash flows (amounts reported by functions can make it difficult for users to forecast future operating expenses because functions combine expense items with different natures that respond differently to changes in the economic environment); and
 - many respondents (mainly preparers and their representative bodies) disagreed with the proposal because providing such information would require costly changes to systems and reporting processes.¹
- This topic was discussed at several past meetings with CMAC and GPF, and jointly:
 - November 2021 GPF meeting
 - March 2022 CMAC meeting
 - Optional workshops with CMAC and GPF Aug-Sep 2020

¹ An analysis of the challenges for preparers in providing such information is given in [October 2021 Agenda Paper 21C](#) and [April 2022 Agenda Paper 21A](#).

Operating expenses: Background (2)

- The IASB discussed alternatives to the proposal (summary included in slide 17 in appendix)
- Specifically, the IASB explored whether a better balance of costs and benefits could be achieved by requiring entities to disclose, for specified expense items, the amounts included in each line item(s) in the statement(s) of financial performance (referred to as P/L or income statement) (see illustration of such an approach on slide 13)
- The feedback received from limited outreach with users and preparers indicates that:
 - having a better understanding of the composition of functions would provide useful information, possibly providing more benefits than the proposal in the ED; and
 - disclosing, for a limited number of expense items, the amounts included in each line item(s) in the P/L is likely to be more feasible for preparers than the proposal in the ED.
- The feedback received and the discussion at the April 2022 IASB meeting suggests that requiring an entity to disclose, at a minimum, the amounts of depreciation, amortisation, and employee benefits included in each line item(s) in the P/L could be an alternative to the proposal in the ED that provides useful information without undue costs— hence, such an approach should be the basis for the way forward

Operating expenses: Background (3)

- The next step is to explore:
 - which expense items (other than depreciation, amortisation, and employee benefits) could be added to a requirement to disclose amounts included in each line item in P/L; and
 - for the expense items selected should the requirement be to disclose any related line items in the P/L, or any related functions (whether presented or disclosed)?

Which expenses to include in the analysis?

- We expect that disclosing, for an expense item, the amount included in each line item(s) in the P/L:
 - may be feasible for preparers when an entity is already collecting information on the total amount of an expense item and thus may be able to determine, without undue cost of effort either:
 - the item in the P/L in which the expense is included; or
 - the line items in the P/L in which the expense is included, with the amounts as they relate to each
 - will provide users with useful information if an expense item is located in multiple line items in the P/L; or if expense is in a single line item but there is diversity between entities in where this item is included in P/L.
- To make the proposals feasible for preparers we think any requirement to disclose amounts included in line items in the P/L should only be linked to disclosures an entity provides already. The question is whether this requirement should extend to specified items only (from the list of already required disclosures), and if so, should anything be added to the list of depreciation, amortisation and staff benefits, or should this requirement extend to all expenses by nature disclosed in the notes.
- Slides 8–9 provide:
 - a (non-exhaustive) overview of expense items that are either required by IFRS Accounting Standards or which an entity may commonly disclose in the notes; and
 - an initial assessment of the characteristics of those items that maybe considered when assessing usefulness of possible disclosure of the relationship with line items presented in the P/L.

Which expenses to include in the analysis: Examples (1)

Income/expense item and the IFRS Accounting Standard requiring its disclosure	Item expected to be in <u>more</u> than one line item in the P/L?	Expected diversity in where similar items are included in the P/L	Similar disclosure provided today ¹
Depreciation, Amortisation, Employee benefits (IAS 1)	Yes	Yes	<ul style="list-style-type: none"> Evidence of some entities providing this information today, in particular for depreciation and amortisation (less so for employee benefits)
Impairment of goodwill, Other impairments (IAS 36)	Maybe (if goodwill impairment presented separately)	Yes	<ul style="list-style-type: none"> Yes - IAS 36 (paragraph 126) requires disclosure of line item(s) in P/L in which expense item is included Goodwill impairment often presented as separate line item
Inventory write-downs (IAS 2)	Generally no (unless some raw materials relate to functions other than 'cost of sales')	Yes	<ul style="list-style-type: none"> No evidence
Raw materials (commonly disclosed not required)	Generally no	No	<ul style="list-style-type: none"> No evidence
Provision charge (IAS 37)	Maybe (if different classes of provisions, for example restructuring and litigation)	Yes	<ul style="list-style-type: none"> If restructuring presented as a separate function, the cost will include restructuring provision charge
Variable lease payments Short-term leases and leases for which the underlying asset is of low value (IFRS 16)	Maybe	Don't know	<ul style="list-style-type: none"> No evidence

¹Excludes information disclosed outside of financial statements prepared in accordance with IFRS Accounting Standards.

Which expenses to include in the analysis: Examples (2)

Income/expense item	Item expected to be in <u>more</u> than one line item in the P/L?	Expected diversity in where similar items are included in the P/L	Similar disclosure provided today ¹
Foreign exchange gains/losses (para 52a of IAS 21 requires disclosure of exchange rate differences recognised in the P/L except for financial instruments measured at FVTPL)	Maybe	<ul style="list-style-type: none"> • Maybe 	<ul style="list-style-type: none"> • Sometimes presented as a separate line item
Gains/losses on derivatives/hedging instruments (not specifically required, except for hedge ineffectiveness, but common disclosure)	Yes	<ul style="list-style-type: none"> • Maybe 	<ul style="list-style-type: none"> • Disclosing line item(s) in P/L in which hedge ineffectiveness is included is a requirement in IFRS 7 (paragraph 24C)
Income/expense from disposals of PP&E, an asset classified as held for sale and a disposal group classified as held for sale (paragraph 41 of IFRS 5)	No	<ul style="list-style-type: none"> • Maybe 	<ul style="list-style-type: none"> • Sometimes disposal gains and losses presented separately, if not paragraph 41c of IFRS 5 requires entities to disclose line items in the P/L in which the gains or losses are included
Income/expense arising from business combinations (fair value gains/losses on contingent consideration, gain on a bargain purchase, acquisition related costs) * of which some is not a requirement, but commonly disclosed	No	<ul style="list-style-type: none"> • Maybe 	<ul style="list-style-type: none"> • Para B64n of IFRS 3 require entities to disclose line item in the P/L in which bargain purchase gain is included

¹Excludes information disclosed outside of financial statements prepared in accordance with IFRS Accounting Standards.

What should the analysis relate to?

- If the IASB proceeds with the proposal to require entities, for some or all disclosed expenses by nature, to disclose the relationships to functions, that relationship can either be to:
 - the functions presented in the P/L
 - all functions, whether disclosed or presented
- In many cases, there may be no difference between the two approaches
- In some cases, there will be a difference, for example when entities combine several functions, disclosed in notes, in a single line item in the P/L

Functions required to be presented or disclosed

Income/expense item	Item expected to always be presented separately (if material)?
Cost of sales (IAS 1)	Yes, required line item for presentation
Research and development expense (IAS 38)	No (but often presented separately in P/L)
Selling expenses * not a requirement, but commonly disclosed	No (often included in 'selling, general and administrative expenses')

Two different presentations

Entities may arrive at different judgements on what subtotals are necessary to provide understandable overview of income and expenses and thus should be presented in the P/L:

More disaggregation in the P/L

Statement of profit or loss	202X ¹
Revenue	3000
Cost of goods sold	(600)
Gross profit	2400
Other income	500
Selling expenses	(400)
Research and development expenses	(300)
General and administrative expenses	(200)
Impairment losses on trade receivables	(100)
Operating profit (loss)	1900

Less disaggregation in the P/L

Statement of profit or loss	202X ¹
Revenue	3000
Cost of goods sold	(600)
Gross profit	2400
Other income	500
Selling, general and administrative expenses ²	(900)
Impairment losses on trade receivables	(100)
Operating profit (loss)	1900

¹ Comparative reporting period not depicted in example for simplification purposes.

²Applying the general principle of disaggregation, an entity is likely to conclude that although there is less disaggregation in the P/L, further disaggregation of functions reported *in the notes* would provide material information – hence, an entity would disclose the amounts shown in the P/L on the left-hand side in the notes

Disclosures if the link is made to functions in the P/L ¹

More disaggregation in the P/L

Specified nature expense items in functions presented ³	202X ²
Depreciation	(500)
<i>Cost of goods sold</i>	<i>(250)</i>
<i>Selling expenses</i>	<i>(150)</i>
<i>Research and development expenses</i>	<i>(50)</i>
<i>General and administrative expenses</i>	<i>(50)</i>
Employee benefits	(400)
<i>Cost of goods sold</i>	<i>(200)</i>
<i>Selling expenses</i>	<i>(100)</i>
<i>Research and development expenses</i>	<i>(50)</i>
<i>General and administrative expenses</i>	<i>(50)</i>

Less disaggregation in the P/L

Specified nature expense items in functions presented ³	202X ²
Depreciation	(500)
<i>Cost of goods sold</i>	<i>(250)</i>
<i>Selling, general and administrative expenses</i>	<i>(250)</i>
Employee benefits	(400)
<i>Cost of goods sold</i>	<i>(200)</i>
<i>Selling, general and administrative expenses</i>	<i>(200)</i>

¹ Approach explored at the April 2022 IASB meeting.

² Comparative reporting period not depicted in example for simplification purposes.

³ Additional specified nature expenses may be required in the final proposal.

Breakout questions for members

Questions for CMAC members:

1. For the items listed on the slides 8–9, would requiring an entity to disclose the amounts included in each function be useful and why?
2. Are there any other items not listed on the slides 8–9, for which providing that information would be useful?
3. Would disclosure of relationship to functions presented in the P/L be sufficient, or do you think disclosure of relationship to all functions, whether presented or disclosed would provide additional useful information (slides 10–13)?

Questions for GPF members:

1. For the items listed on the slides 8–9, would disclosing the amounts included in each function be feasible and why or why not?
2. Are there any expenses by nature not listed on the slides 8–9 that are commonly disclosed? If so, would disclosing related amounts included in each function be feasible and why or why not?
3. Are there particular application challenges to consider when deciding whether disclosure of relationships should be made only for functions presented, or all functions, whether presented or disclosed (slides 10–13)?

Breakout questions for both CMAC and GPF members

1. Considering discussion in earlier questions, would a requirement for an entity to disclose, *for each nature expense item disclosed in the notes*, the amounts included in each line item(s) in the P/L provide useful information without undue costs? If not, which expense items, in addition to depreciation, amortisation and employee benefits, could be captured in such requirement without undue costs?
2. Whatever the approach, would you prefer the required information is provided:
 - a) in a single note; or
 - b) in the same location as related information? For example, should an entity disclose the line item in the P/L in which inventory expense or write-downs of inventory are included within an 'inventory note' or disclose this information in a separate (single) note?



Primary Financial Statements

Operating expenses - Appendix

Summary of October 2021 and April 2022 IASB meetings

- At the October 2021 IASB meeting ([October 2021 Agenda Paper 21C](#)):
 - the IASB discussed an approach that would give a partial cost relief from disclosing information about operating expenses by nature if, and to the extent that, such disclosure would involve undue cost or effort – but that such a cost relief would not apply to depreciation, amortisation, and employee benefits or other operating expenses by nature required by IFRS Accounting Standards. A partial cost relief would work in conjunction with a requirement to give an analysis of each functional line item by nature (a ‘partial matrix’)
 - no decisions were made, but the staff was asked to explore what a ‘partial matrix’ would comprise
- At the April 2022 IASB meeting ([April 2022 Agenda Paper 21A](#)):
 - the IASB discussed a ‘partial matrix’ that would require that specified nature expenses are disaggregated by function. As a minimum such an approach would require disaggregation by function of depreciation, amortisation, and employee benefits (Limited outreach with preparers and users in early 2022 indicates that such an approach would arrive at a more balanced outcome than the proposal. Specifically, users have indicated that understanding the composition of functions better would be beneficial, and preparers have indicated that disclosing, for specified expenses by nature, the amounts of *those* expense items included in each line item(s) in the P/L would be a feasible approach)
 - no decisions were made, but the staff was asked to explore which specified expenses by nature would be required to be disaggregated by function

Illustration of Exposure Draft proposal (paragraph 72)

Statement of profit or loss	202X ¹
Revenue	3000
Cost of goods sold	(600)
Gross profit	2400
Other income	500
Selling expenses	(400)
Research and development expenses	(300)
General and administrative expenses	(200)
Impairment losses on trade receivables	(100)
Operating profit (loss)	1900

Exposure Draft proposal	202X ¹
Changes in inventories of finished goods and work in progress	200
Raw material used	(500)
Reversal of inventory write-downs	50
Employee benefits	(400)
Depreciation	(400)
Amortisation	(100)
Impairment of property, plant and equipment	(100)
Impairment losses on trade receivables	(100)
Property taxes	(25)
Litigation expenses	(100)
Gains (losses) on derivatives	(25)
Other miscellaneous expenses	(100)
Operating expenses total	(1600)

¹ Comparative reporting period not depicted in example for simplification purposes.

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