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File Reference No. 2022-ED500
Financial Accounting Standards Board
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Proposed Accounting Standards Update, Income Statement — *Reporting Comprehensive Income (Subtopic 220-40): Disaggregation of Income Statement Expenses* (File Reference No. 2023-ED500)

Dear Ms. Salo:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Income Statement — Reporting Comprehensive Income (Subtopic 220-40): Disaggregation of Income Statement Expenses,* issued by the Financial Accounting Standards Board (FASB or Board).

We generally support the Board's efforts to address requests from investors for more detailed information about certain expenses. However, we have identified certain areas that could be further clarified to improve the operability of the proposed guidance.

We encourage the Board to continue providing additional opportunities, in addition to the roundtable on 13 December 2023, for investors and preparers to jointly and transparently discuss any significant expected implementation challenges. This dialogue can help make sure the disaggregated information that would be provided would address financial statement user requests and help preparers better apply the guidance. For example, we believe the further disaggregation of inventory and manufacturing expense into categories of costs incurred would be an area requiring further discussion.

In addition, we believe that both the comment letter process and the ongoing dialogue are critical to informing any Board decision on an appropriate effective date or dates that would give preparers sufficient time to adjust systems and processes, as necessary, to gather the information that investors need.

Finally, in connection with implementing a final standard, we expect that some entities may consider certain changes to their income statement presentation. However, ASC 250 does not provide specific guidance on whether a reclassification would be considered a change in accounting principle. Therefore, to mitigate implementation complexity and potential diversity, we recommend that the Board clarify, where GAAP does not already provide specific alternatives (e.g., shipping and handling expense), whether a change from one acceptable financial statement presentation to another is a reclassification rather than a change in accounting principle.

Our comments to certain questions, and our recommendations for the Board's consideration, are included in Appendix A of this letter. In Appendix B, we provide further recommendations to clarify certain areas of the proposed guidance.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst + Young LLP

Appendix A — Responses to questions raised in the Proposed Accounting Standards Update, *Income Statement — Reporting Comprehensive Income (Subtopic 220-40): Disaggregation of Income Statement Expenses*

Expense captions subject to disaggregation requirements

> **Question 1:** The amendments in this proposed Update would require that a public business entity disclose disaggregated relevant expense captions in the notes to financial statements. For preparers and practitioners, are the proposed amendments for identifying relevant expense captions operable? Please explain why or why not. If not, what changes would you make?

We believe that the proposed amendments on identifying relevant expense line items would be operable.

However, in some circumstances we observe that certain relevant expense line items and/or inventory and manufacturing expenses may be comprised of substantially all of one of the categories in proposed paragraphs 220-40-50-4 and 220-40-50-18, respectively.

For example, an entity may present salaries and benefits as a separate expense line item that may be comprised of substantially all of employee compensation (as defined in the proposal) with less significant other costs (e.g., contract employee costs) included in the relevant expense line item. In another example, inventory purchases may comprise substantially all of a retailer's disaggregated inventory and manufacturing expense disclosure.

As such, we believe the Board should amend proposed paragraphs 220-40-50-4 and 220-40-50-18 to allow qualitative information about the nature of the relevant expense line item and/or inventory and manufacturing expense when the item is comprised of substantially all of one category. We note the term "substantially all" is an existing concept in US GAAP that is interpreted to mean 90% or more.[1]

While ASC 105-10-05-6 states that "the provisions of the Codification need not be applied to immaterial items," in some circumstances disaggregated amounts of certain expense line items may not be material, despite the aggregate amount of such expense being material. For example, if depreciation expense during the period is material to financial statement users, but certain disaggregated amounts of depreciation included in one or more relevant expense line items are not material to those relevant expense line items and the financial statements taken as a whole, the entity may conclude that the disaggregated depreciation expense is not required to be quantitatively disclosed as a required expense category for those relevant expense line items. To improve operability and mitigate diversity in practice, we recommend the Board clarify how the application of ASC 105-10-05-6 interacts with the proposal.

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[1] ASC 842-10-55-2.

Entities in scope

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

It is not clear whether the Board intended for the proposal to apply to certain private companies included in filings with the Securities and Exchange Commission (SEC).

The definition of a public business entity includes an entity that is required to "… file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC **(including other entities whose financial statements or financial information are required to be or are included in a filing)**" (emphasis added).

This definition includes entities whose financial statements are included in an SEC filing in accordance with Rules 3-05, 3-09 and 3-14. For example, when a private company is acquired by a public entity, the private company's financial statements may be required to be included in the public entity's SEC filing. In this situation, the private company would meet the definition of a public business entity, and the proposed guidance would apply to it.

In such circumstances, the private entity may face significant challenges gathering the information necessary to apply the guidance in a timely manner (e.g., existing systems may not be configured to gather information in a manner required by an acquirer). We recommend the Board consider feedback from financial statement users in determining whether the disaggregated income statement information for such entities is critical to their analysis.

In addition, if the Board retains the proposed scope, we recommend that it clarify whether the guidance would apply to not-for-profit conduit bond obligors. The definition of public business entity includes an entity that is a conduit bond obligor, which would include a not-for-profit conduit bond obligor, but paragraph BC20 states that the proposal would not apply to not-for-profit entities.

Required expense categories

Question 3: The proposed amendments would require that an entity disclose the amounts of (a) inventory and manufacturing expense, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) DD&A that are included in each relevant expense caption. For investors, would this proposed disclosure provide decision-useful information? If so, how would that information be used? If not, what changes would you make? Would any of the proposed categories not provide decision-useful information? For example, are there categories that would be more decision useful than the ones being proposed?

We defer to investors to provide feedback on whether the proposed categories would provide decision-useful information.

However, we recommend the Board consider the additional complexities for entities with certain arrangements in which they do not directly incur costs (e.g., proportionately consolidated investments) when determining an appropriate effective date (i.e., to give partners time to develop processes to share required information). Investors in non-controlled proportionately consolidated arrangements may find it challenging to gather the information necessary from the lead investor to disaggregate their share of the expenses incurred. For example, investors may receive information on their portions of total labor expense but not currently know whether the entire expense meets the definition of employee compensation.

Question 6: The proposed amendments would leverage the existing definition of employee in Topic 718, Compensation — Stock Compensation, and would add a definition of employee compensation. For preparers and practitioners, are the proposed definitions of employee and employee compensation operable, including for entities with international operations, and would the proposed amendments affect entities' current application of the definition of employee in Topic 718? Please explain. What changes, if any, would you make? For preparers, would the proposed practical expedient that would allow certain entities to disclose salaries and benefits in accordance with SEC Regulation S-X Rule 9-04 be less costly to apply than applying the proposed definition of employee compensation? For investors, would permitting the application of that proposed practical expedient affect the decision usefulness of the proposed disclosures? For all stakeholders, should the definition of employee compensation include additional costs or exclude any of the costs proposed? Please explain why or why not.

We generally believe the proposed definitions of employee and employee compensation would be operable, including for entities with international operations. However, for purposes of determining an appropriate effective date, the Board should be aware of potential initial complexity for entities with diverse international operations, because they may need to perform an analysis by country to evaluate the pertinent laws of each jurisdiction in determining whether an employee-employer relationship exists.

We do not believe the proposed amendments would affect entities' current application of the definition of employee in ASC 718.

We recommend that the application of the proposed practical expedient not be limited to entities that only present salaries and employee benefits on the face of the income statement. We believe it should also be applicable to entities that disclose such amounts in the notes in accordance with Regulation S-X Rule 9-04. This would acknowledge that while entities subject to Rule 9-04 generally present salaries and benefits on the face of the income statement, some may only disclose them.

Further disaggregation of inventory and manufacturing expense

> **Question 8:** The proposed amendments would require further disaggregation of inventory and manufacturing expense into the following categories of costs incurred: (a) purchases of inventory, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) DD&A. Those costs incurred categories would include costs that flow into the balance sheet as inventory and also would include manufacturing costs that are expensed directly. The costs incurred categories would not represent costs flowing from inventory on the balance sheet to the income statement when that inventory is sold or impaired. Residual costs incurred would be included in an "other" category. For investors, would this proposed disclosure provide decision-useful information? If so, how would that information be used? If not, what changes would you make? Would any of the proposed costs incurred categories not provide decision-useful information? For example, are there categories that would be more decision useful than the ones being proposed? Should the proposed requirement to further disaggregate costs incurred that flow into the balance sheet as inventory be expanded to include assets other than inventory? If so, which assets?

We defer to investors about whether the further disaggregation of inventory and manufacturing expense into certain categories of costs incurred would provide decision-useful information. Refer to our response to Question 1 regarding materiality and our response to Question 19 regarding transition and effective date.

We recommend the Board clarify whether purchases of inventory amounts would be disclosed net of any consideration received from a vendor in accordance with ASC 705-20.

> **Question 10:** For preparers and practitioners, is the proposed requirement to classify certain expenses as part of manufacturing activities and disclose how an entity defines other manufacturing expenses (other manufacturing expenses together with inventory expense constitute inventory and manufacturing expenses) operable? Please explain why or why not. If not, what changes would you make?

We generally believe the proposed requirements to classify certain expenses as part of manufacturing activities and disclose how an entity defines other manufacturing expenses would be operable.

Proposed paragraph 220-40-50-6 states that "other manufacturing expenses generally include, but are not limited to, certain costs incurred as part of an entity's manufacturing activities that are not capitalizable (for example, unallocated manufacturing overhead related to abnormally low production.)" However, this broad description could result in diversity among entities and across industries. Therefore, we suggest the Board consider investor feedback in determining whether this diversity should be mitigated with additional guardrails or examples of what may or may not be a manufacturing expense.

Additionally, the Board should consider clarifying whether other manufacturing expenses would only apply to manufacturing entities, rather than to any entity with inventory-related costs.

Separately, we recommend the Board consider whether inventory and manufacturing expenses should include the gain or loss of a derivative that is designated as a fair value hedge of inventory. For example, when an entity enters into a fair value hedge of inventory, the changes in the fair value of the inventory (hedged item) related to the risk being hedged are reflected in earnings and offset by the changes in fair value of the derivative (hedging instrument).

Based on our understanding, the gain or loss of the derivative (hedging instrument) would be a separate category in accordance with proposed paragraph 220-40-50-12(h) within the cost of products sold expense line item, but the change in the fair value of the hedged inventory would be shown in inventory and manufacturing expense. We recommend that both the changes in fair value of the derivative (hedging instrument) and the changes in inventory be included in the inventory and manufacturing expense category to provide more transparency to financial statement users.

Integration of existing disclosure requirements

Question 12: The proposed amendments would require that an entity include certain existing disclosures of expenses in the same tabular format disclosure as the disclosures that would be required by the proposed amendments. For investors, would including those expenses in the same tabular format disclosure provide decision-useful information? Would this improve your ability to locate relevant expense information in the notes to financial statements? Please explain why or why not. For preparers and practitioners, is this proposed requirement operable? Please explain why or why not. For all stakeholders, are there other existing disclosures that are not reflected in the proposed amendments and should be included in the lists in paragraph 220-40-50-12, paragraph 220-40-50-13, or both? Please explain why or why not.

We believe that the proposed requirement to integrate certain existing disclosures of expenses in the disaggregated income statement expense tables would be operable.

Regarding the completeness of the lists in proposed paragraph 220-40-50-12, the Board should consider whether paragraph 832-10-50-3(c) should be included in the list. Paragraph 832-10-50-3(c) requires an entity to disclose the line items on the income statement that are affected by transactions with a government within the scope of that Topic, and the amounts applicable to each financial statement line item in the current reporting period. For example, government assistance from a grant related to income may be presented as a contra expense.

Additionally, ASC 350-40-50-3 (inclusive of its reference to ASC 360-10) does not appear to require separate disclosure of amortization of capitalized implementation costs. Therefore, we believe that proposed paragraph 220-40-50-13(h), "amortization of capitalized implementation costs of hosting arrangements that are service contracts (see paragraph 350-40-50-3)," should be removed. If the Board believes that amortization of capitalized implementation costs is required to be separately disclosed, we suggest specifying that it would be a specific additional disclosure.

Selling expenses

Question 15: The proposed amendments would require that an entity disclose selling expenses and how it defines selling expenses. Should a definition of selling expenses be developed, or should an entity be required to determine what constitutes a selling expense? For investors, would the proposed requirement provide decision-useful information? If so, how would that information be used? If not, what changes would you make? For preparers and practitioners, is the proposed requirement operable? Please explain why or why not.

We believe that the proposed requirement for a public business entity to disclose selling expenses and how it defines selling expenses would be operable.

Additionally, we recommend the Board clarify in the Codification that selling expenses are those presented as an expense. While paragraph BC86 clarifies that selling expenses were intended to only be those presented as expenses, some entities recognize selling costs as a credit against revenue in accordance with paragraph 606-10-32-25 (consideration payable to a customer). Therefore, we believe clarification in the Codification could enhance operability.

Interim reporting

Question 16: The proposed amendments would require the disclosures on both an annual basis and an interim basis. Do you agree with those proposed amendments? Please explain why or why not.

Proposed paragraph 220-40-50-3 states "an entity is required to include only the disclosures listed in paragraphs 220-40-50-12 through 50-13 in a tabular format disclosure for interim reporting purposes if the disclosure requirements referenced in those paragraphs are required in interim reporting periods." However, under current guidance it is not clear whether disclosure for interim reporting purposes is required for certain disclosures. We recommend the Board consider completing its project on Interim Reporting — Narrow Scope Improvements before it issues a final ASU to facilitate preparer implementation efforts.

Transition and effective date

Question 19: Regarding the effective date, how much time would be needed to implement the proposed amendments? Should early adoption be permitted? Please explain why or why not.

We defer to preparers about how much time would be needed to implement the proposed amendments. However, we expect that preparers with inventory and manufacturing expense may require significant time to implement the system, process and control changes, as necessary, to capture the data needed for the further disaggregation of inventory and manufacturing expense. Therefore, we believe the FASB should consider using tiered effective dates, whereby entities would initially be required to disaggregate relevant expense line items and at a later date then be required to further disaggregate inventory and manufacturing expenses.

Appendix B — Other comments

The following are additional clarifications we recommend that the Board consider when finalizing the proposed guidance.

1. **ASC 220-40-55-17 —** We recommend amending proposed paragraph 220-40-55-17 to align with ASC 220-40-55-18 and state that operating lease cost would also be included in research and development (R&D) expense, as well as cost of sales (COS) and selling, general and administrative (SG&A) expenses. The example in proposed paragraph 220-40-55-18 includes operating lease expense in the qualitative disclosures for the other remaining items within R&D expenses.

2. **Tabular integration of other disclosure requirements —** The words "integration" and "incorporate" (paragraphs BC72 and BC73) may be interpreted as inferring that such disclosures would be included in both the relevant footnote and the new disaggregated expense disclosures footnote. We recommend that the Board clarify its intent on whether, and if so when, duplication of disclosure information would be required.[2]

3. **BC71 —** BC71 states that "Depending on the extent to which depreciation or intangible asset amortization is capitalized to assets other than inventory, the Board acknowledges that the total amounts of depreciation and intangible asset amortization disclosed in accordance with paragraph proposed 220-40-50-4 may not be equal to total depreciation and intangible asset amortization disclosed in each respective footnote in accordance with Subtopics 360-10 and 350-30." We recommend that the Board consider providing examples to clarify when total depreciation and/or intangible asset amortization in accordance with proposed paragraph 220-40-50-4 may not be equal.

4. **BC36 —** We recommend that the Board consider extending the principle in paragraph BC36 to expenses that are accrued as part of a liability, because those expenses will not reflect the natural classification of costs to be incurred — similar to costs that are capitalized into the cost of an asset. For example, benefit reserves (life insurance) and loss adjustment expense reserves (property and casualty) for insurance entities include accrued compensation expense for the adjudication of claims that have been reported or incurred but not reported.

5. **220-40-50-18(b) —** We recommend the Board consider removing the reference to "(see paragraph 220-40-50-4(b))" from the proposed paragraph 220-40-50-18(b). This is because proposed paragraph 220-40-50-4(b) states "Employee compensation (disclosing separately any one-time employee termination benefits, if applicable), see paragraph 220-40-50-12(e))" and references the proposed paragraphs for the tabular integration of other disclosure requirements under proposed paragraphs 220-40-50-12 through 50-15. However, the integration of other disclosure requirements is not required for the further disaggregation of inventory and manufacturing expense.

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[2] As a reference, the proposed amendments on segment reporting (ASC 280) explicitly states that duplication of disclosure information is not required.

6. **Paragraph 7 —** We recommend the Board change the table in paragraph 7 on the disclosure requirements for expenses with existing mapping requirements as follows:

Subtopic	Paragraph(s) Amended
...	...
~~606-10, Revenue from Contracts with Customers--Overall~~	~~606-10-50-4~~
...	...
832-10 Government Assistance — Overall	832-10-50-3

Paragraph 606-10-50-4 requires that after the adoption of ASC 326 "Credit losses recorded (in accordance with Subtopic 326-20 on financial instruments measured at amortized cost) on any receivables or contract assets arising from an entity's contracts with customers, which the entity shall disclose separately from credit losses from other contracts." We note that ASC 606 is not included in either proposed paragraph 220-40-50-12 or 50-13. Because the impairment loss results from the application of ASC 326-20, which is already included in the paragraph 7 mapping requirements, we do not believe a reference to ASC 606 should also be included.

Additionally, we believe reference to ASC 832 should be included, as noted in our response to Question 12.