

To the Point

FASB – proposed guidance

FASB proposes requiring public business entities to disaggregate certain income statement expenses

The proposal addresses investors' requests for more detailed information about expenses.

What you need to know

- ▶ The FASB proposed requiring public business entities to disclose, on an annual and interim basis, disaggregated information about certain income statement expense line items.
- ▶ They would have to disclose inventory and manufacturing expense, employee compensation, depreciation, intangible asset amortization and, for oil- and gas-producing activities, depreciation, depletion and amortization (DD&A) for each line item that contains those expenses. For inventory and manufacturing expense, they would also have to further disclose inventory purchases, employee compensation, depreciation, intangible asset amortization and DD&A.
- ▶ Specified expenses, gains or losses that are already disclosed under existing US GAAP would also have to be included in the disaggregated line item disclosures, and any remaining amounts would have to be described qualitatively.
- ▶ A separate disclosure of total selling expenses and an entity's definition of those expenses would also be required.
- ▶ Comments are due by 30 October 2023, and the FASB will host a public roundtable on 13 December 2023.

Overview

The Financial Accounting Standards Board (FASB or Board) **proposed** requiring a public business entity (PBE) to provide disaggregated disclosures, in the notes to the financial statements, of specified categories of expenses that are included in line items¹ on the face of the income statement. The disclosures would be required on an annual and interim basis.

The proposal would also require a PBE to disclose the total amount of selling expenses and, on an annual basis, how it defines selling expenses and other manufacturing expenses.

The proposal addresses investors' requests for more detailed expense information, which they said is critical to understanding an entity's performance, assessing its prospects for future cash flows, and comparing its performance both over time and with that of other entities.

The proposal would not change what a PBE presents on the face of its income statement.

Key considerations

Required expense categories

The proposal would require disclosure in a tabular format of the following categories for each "relevant" expense line item on the face of the income statement:

- ▶ Inventory and manufacturing expense
- ▶ Employee compensation
- ▶ Depreciation
- ▶ Intangible asset amortization
- ▶ DD&A recognized as part of oil- and gas-producing activities

A relevant expense line item would be any line item in continuing operations that contains any of the above expense categories. For example, income tax expense would not be a relevant expense line item because it does not contain any of these expense categories.

Inventory and manufacturing expense

Inventory and manufacturing expense would comprise inventory and other manufacturing expenses. Inventory expense would be defined as "an expense resulting from the derecognition of inventory due to sale to customers, consumption in the production of goods or services for such sale, or remeasurement (for example, an impairment) in accordance with Section 330-10-35 or any other Subsequent Measurement Section within an Industry Subtopic in Topic 330 on inventory." The proposal does not define other manufacturing expenses but states such costs "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)."² The proposal would also require an annual disclosure of how a PBE defines other manufacturing expenses.

Employee compensation

The proposal's definition of employee would be the same as that in Accounting Standards Codification (ASC) 718, *Compensation – Stock Compensation*. Under the proposal, employee compensation³ would include all forms of cash consideration (including deferred cash compensation), shared-based payment arrangements and various other benefits (e.g., medical care, pension, postretirement, nonretirement postemployment) given by an entity in exchange for service rendered by employees or for the termination of employment. One-time employee termination benefits under ASC 420, *Exit or Disposal Cost Obligations*, would be disclosed separately from employee compensation.

Depreciation and intangible asset amortization

The amounts provided separately for depreciation and intangible asset amortization would be consistent with those reported under the requirements in ASC 360, *Property, Plant, and Equipment*, and ASC 350, *Intangibles – Goodwill and Other*, respectively. Additionally, the amortization of a finance lease right-of-use asset and amortization of leasehold improvements recognized in accordance with ASC 842, *Leases*, would be included in either the depreciation or intangible asset amortization expense category.

DD&A

In the Background Information, Basis for Conclusions and Alternative View section of the proposal, the FASB acknowledged that DD&A is an industry-specific expense, but said it proposed including it as an expense category that would be required to be disclosed because “it represents a potentially significant noncash expense that is recognized systematically like depreciation and intangible asset amortization.”⁴

Existing disclosures that would be included in the disaggregated expense tables

The proposal would require certain amounts already disclosed under existing US GAAP to also be disclosed as a separate category in the disaggregated expense tables, if the amounts are recognized in the relevant expense line item. These include:

- ▶ Specified expenses, gains and losses for which there is an existing requirement to disclose both the amount and line item in the income statement where they are included⁵
- ▶ Specified expenses, gains and losses for which there is an existing requirement to disclose the amount, but no requirement to disclose the line item in the income statement where they are included if the amount is recorded entirely in one line item⁵

The FASB provided an example related to the amounts described in the second bullet: If cost of sales is a relevant expense line item and amortization of costs to fulfill a contract with a customer was recognized entirely in cost of sales, a PBE would be required to include this expense as a separate category in the disaggregated expense table. The disclosure would not be required if sales and marketing is a relevant expense line item, and amortization of costs to fulfill a contract with a customer is recognized in both cost of sales and sales and marketing.

Further disaggregation of inventory and manufacturing expense

The proposal would require further disaggregation of the inventory and manufacturing expense category into the following, which would include any costs capitalized to inventory and related to an entity’s manufacturing activities directly expensed during the current period:

- ▶ Purchases of inventory
- ▶ Employee compensation
- ▶ Depreciation
- ▶ Intangible asset amortization
- ▶ DD&A recognized as part of oil- and gas-producing activities
- ▶ Costs capitalized to inventory and manufacturing expenses not included in the bullets above
- ▶ Changes in inventories
- ▶ Other adjustments and reconciling items

Certain existing disclosures would have to be included in the same tabular disclosure under the proposal.

The amount of inventory and manufacturing expense recognized during a reporting period and the amount of costs incurred that are either capitalized to inventory or expensed as incurred during the reporting period will generally not be equal. Therefore, an entity would include a change in inventory balances to reconcile the amounts. The amount disclosed for changes in inventories in the current period would equal the difference between the amount of inventory included on the balance sheet presented at the end of the prior period and the amount of inventory included on the balance sheet presented at the end of the current period.

Other adjustments and reconciling items would include other amounts that are necessary to reconcile costs incurred to expenses recognized during the reporting period. This could include the amount of inventory derecognized during the period that does not meet the definition of inventory expense under the proposal (e.g., inventory sold to noncustomers in connection with a disposal) or amount attributable to foreign currency translation.

Qualitative disclosures about any remaining amounts

The proposal would require qualitative disclosures about any remaining amounts in relevant expense line items and in further disaggregation of inventory and manufacturing expense not separately disclosed.

Selling expenses

The proposal would require disclosure of the total amount of selling expenses recognized in continuing operations and, on an annual basis, a PBE's definition of selling expenses.

How we see it

PBEs should evaluate whether their existing systems are capable of capturing the data that would be required and whether additional processes and controls would be necessary to prepare the proposed disclosures.

Effective date and transition

PBEs would be required to apply the guidance prospectively but would be permitted to apply it retrospectively. The FASB said it would determine an effective date and whether early adoption would be permitted after it receives feedback on the proposal.

Endnotes:

- ¹ Line items are also referred to as captions.
- ² ASC 220-40-50-6.
- ³ As a practical expedient for determining what amounts are classified as employee compensation, an entity that presents an expense line item for salaries and employee benefits (or a similarly named line item) on the face of its income statement to comply with the requirements in Securities and Exchange Commission Regulation S-X Rule 9-04 (ASC 942-220-S99-1) may use those amounts rather than amounts calculated in accordance with the definition of employee compensation included in this proposal.
- ⁴ Paragraph BC44.
- ⁵ ASC 220-40-50-12 and ASC 220-40-50-13, respectively.

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Appendix: Illustration of proposed disclosures

The following illustration, which is included in the proposal, shows one type of tabular format a PBE could use to make the proposed disclosures.

For the year ended December 31, 20X3, Entity XYZ, a manufacturer with significant service operations, presents the following comparative statement of operations and related disclosures in the notes to the financial statements. For illustration purposes related to 'Existing disclosures that would be included in the disaggregated expense tables', assume Entity XYZ recognizes the following expenses: (1) impairment of property, plant and equipment classified in selling, general and administrative (SG&A),¹ (2) warranty expense entirely within cost of products sold² and (3) operating lease cost in both cost of services and SG&A²:

Consolidated Statement of Operations			
	20X3	20X2	20X1
Revenue:			
Products	\$ 82,144	\$ 79,137	\$ 75,180
Services	26,132	23,146	21,989
Total revenues	108,276	102,283	97,169
Operating expenses:			
Cost of products sold	63,456	60,898	57,244
Cost of services	10,496	9,568	8,898
Selling, general, and administrative	20,849	18,871	18,116
Total operating expenses:	94,801	89,337	84,258
Operating income	13,475	12,946	12,911
Interest expense	4,971	4,213	4,297
Income before income taxes	8,504	8,733	8,614
Income tax expense	1,786	1,834	1,809
Net income	\$ 6,718	\$ 6,899	\$ 6,805

← Relevant expense line items

Example footnote disclosure: Disaggregation of relevant expense line items

<p>Cost of products sold</p> <table border="1"> <thead> <tr> <th>Cost of products sold</th> <th>20X3</th> <th>20X2</th> <th>20X1</th> </tr> </thead> <tbody> <tr> <td>Inventory and manufacturing expense^(a)</td> <td>\$ 53,688</td> <td>\$ 51,935</td> <td>\$ 48,680</td> </tr> <tr> <td>Employee compensation</td> <td>2,046</td> <td>1,827</td> <td>1,279</td> </tr> <tr> <td>Depreciation</td> <td>1,395</td> <td>1,311</td> <td>1,232</td> </tr> <tr> <td>Warranty expense</td> <td>4,394</td> <td>3,952</td> <td>3,894</td> </tr> <tr> <td>Other cost of products sold^(b)</td> <td>1,933</td> <td>1,873</td> <td>2,159</td> </tr> <tr> <td>Total cost of products sold</td> <td>\$ 63,456</td> <td>\$ 60,898</td> <td>\$ 57,244</td> </tr> </tbody> </table> <p>^(a) The company defines manufacturing expenses (other than inventory expense) as those that are incurred for the purpose of producing units of inventory, but are not capitalizable. Other manufacturing expenses include costs incurred related to idled manufacturing plants.</p> <p>^(b) Other cost of products sold consisted primarily of amounts paid to carriers for freight services related to contract fulfillment for the years ended December 31, 20X3, 20X2 and 20X1.</p>	Cost of products sold	20X3	20X2	20X1	Inventory and manufacturing expense ^(a)	\$ 53,688	\$ 51,935	\$ 48,680	Employee compensation	2,046	1,827	1,279	Depreciation	1,395	1,311	1,232	Warranty expense	4,394	3,952	3,894	Other cost of products sold ^(b)	1,933	1,873	2,159	Total cost of products sold	\$ 63,456	\$ 60,898	\$ 57,244	<p>Cost of products sold: inventory and manufacturing expense</p> <table border="1"> <thead> <tr> <th></th> <th>20X3</th> <th>20X2</th> <th>20X1</th> </tr> </thead> <tbody> <tr> <td>Purchases of inventory</td> <td>\$ 20,213</td> <td>\$ 19,199</td> <td>\$ 16,319</td> </tr> <tr> <td>Employee compensation</td> <td>15,532</td> <td>14,712</td> <td>12,799</td> </tr> <tr> <td>Depreciation</td> <td>8,795</td> <td>8,678</td> <td>8,418</td> </tr> <tr> <td>Intangible asset amortization</td> <td>3,914</td> <td>4,050</td> <td>3,929</td> </tr> <tr> <td>Other inventory and manufacturing costs^(c)</td> <td>5,619</td> <td>5,733</td> <td>5,834</td> </tr> <tr> <td>Total inventory and manufacturing costs</td> <td>54,073</td> <td>52,372</td> <td>47,299</td> </tr> <tr> <td>Other adjustments and reconciling items^(d)</td> <td>(542)</td> <td>424</td> <td>538</td> </tr> <tr> <td>Changes in inventories</td> <td>157</td> <td>(861)</td> <td>843</td> </tr> <tr> <td>Total inventory and manufacturing expense</td> <td>\$ 53,688</td> <td>\$ 51,935</td> <td>\$ 48,680</td> </tr> </tbody> </table> <p>^(c) Other inventory and manufacturing costs consisted primarily of power, fuel, and other utilities costs for the years ended December 31, 20X3, 20X2, and 20X1.</p> <p>^(d) Other adjustments and reconciling items consisted of reconciling adjustments attributable to differences in the foreign exchange rates used to translate beginning inventory, ending inventory, and costs incurred from various functional currencies into the reporting currency for the years ended December 31, 20X3, 20X2, and 20X1. For the year ended December 31, 20X3, other adjustments and reconciling items also included the carrying amount of inventory sold to noncustomers in connection with a disposal transaction.</p>		20X3	20X2	20X1	Purchases of inventory	\$ 20,213	\$ 19,199	\$ 16,319	Employee compensation	15,532	14,712	12,799	Depreciation	8,795	8,678	8,418	Intangible asset amortization	3,914	4,050	3,929	Other inventory and manufacturing costs ^(c)	5,619	5,733	5,834	Total inventory and manufacturing costs	54,073	52,372	47,299	Other adjustments and reconciling items ^(d)	(542)	424	538	Changes in inventories	157	(861)	843	Total inventory and manufacturing expense	\$ 53,688	\$ 51,935	\$ 48,680
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Example footnote disclosure: Selling expenses

During the years ended December 31, 20X3, 20X2 and 20X1, selling expenses were \$13,425, \$12,123 and \$11,585, respectively. The entity's selling expenses includes those expenses relating to marketing and promotional activities and client relationship management.

¹ This is an expense for which there is an existing requirement to disclose the amount and line item in the income statement where it is included (ASC 220-40-50-12).

² These are expenses for which there is an existing requirement to disclose the amount, but no requirement to disclose the line item in the income statement where they are included. The warranty expense is recorded entirely in one line item and, therefore, included in the cost of products sold disaggregated expense table. The operating lease cost is not recorded entirely in one line item and, therefore, not included as a separate category in the disaggregated expense tables but is included in other SG&A and other cost of services (ASC 220-40-50-13).