

October 31, 2023

Hillary H. Salo  
Technical Director  
Financial Accounting Standards Board  
801 Main Avenue  
P.O. Box 5116  
Norwalk, CT 06856-5116

**RE: Disaggregation of Income Statement Expenses (File Reference No. 2023-ED500)**

Dear Ms. Salo:

CFA Institute<sup>1</sup>, in consultation with its Corporate Disclosure Policy Council (“CDPC”)<sup>2</sup>, appreciates the opportunity to comment and provide our perspectives on the Financial Accounting Standards Board’s (“FASB” or the “Board”) Proposed Accounting Standards Update, *[Income Statement: Reporting Comprehensive Income – Expense Disaggregation Disclosures, Disaggregation of Income Statement Expenses](#)* (the “Proposed Update”).

CFA Institute has a long history of promoting fair and transparent global capital markets and advocating for strong investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures and the related audits provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally.

### **EXECUTIVE SUMMARY**

We thank the Board for making progress in the Proposed Update towards meeting investors’ unmet needs for disaggregated income statement information.

The income statement and statement of cash flows are vital for investors’ evaluation of issuers’ financial performance, position, and valuation of debt and equity securities. In contrast to the balance sheet captions, captions on most issuers’ income statements and statements of cash flows are highly aggregated quantities of unknown composition.

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<sup>1</sup> With offices in Charlottesville, VA; New York; Washington, DC; Brussels; Hong Kong SAR; Mumbai; Beijing; Abu Dhabi; and London, CFA Institute is a global, not-for-profit professional association of more than 190,000 members, as well as 160 member societies around the world. Members include investment analysts, advisers, portfolio managers, and other investment professionals. CFA Institute administers the Chartered Financial Analyst® (CFA®) Program. For more information, visit [www.cfainstitute.org](http://www.cfainstitute.org) or follow us on [LinkedIn](#) and X at [@CFAINstitute](#).

<sup>2</sup> The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

As Board Chair Richard Jones recently stated:

*If someone hands you a financial statement... It is fairly easy to look at the balance sheet and then find a footnote to see the details of what make up [each] balance sheet caption. But look at an income statement line item and try to understand what the key components of that [line item] are. What you will find is a hodgepodge of disclosures sprinkled throughout the footnotes, giving pieces. Sometimes they tell you where in the income statement they are, and sometimes they do not.<sup>3</sup>*

While the Proposed Update will result in some decision-useful disclosures of income statement expense captions, several compromises made in the Proposed Update to either reduce implementation costs, or to issue a final standard quickly, weaken its overall decision-usefulness for investors by unnecessarily complicating and limiting disclosure.

We are aware of challenges for preparers, especially in disaggregating costs that were capitalized in prior periods, but disaggregated financial information is investors' top priority for the Board and has been for many years. We believe information technology advances since the 1980s – such as the personal computer, enterprise resource planning software, and the internet – have reduced the cost of producing and disclosing disaggregated financial information significantly, though preparers' objections to disaggregation (and to all other new reporting standards) on the grounds of cost remain unchanged. The Board should take the time that it needs to craft a final standard that truly delivers for investors.

Our response to the Proposed Update is organized in the body of the letter and summarized below as follows.

***Context & Background: Real-World Example, Our Previous Advocacy on Disaggregation & Academic Research*** – First, we provide background and context for our response using a real-world example – the challenge of analyzing Apple's income statement; followed by a brief discussion of our multi-decade history of advocating for disaggregated and cohesive financial statement information; and then emphasized with relevant academic research.

***Summary of Proposed Requirements*** – Second, we summarize the new requirements in the Proposed Update.

***Observations on Proposed Requirements & Recommendations*** – Finally, we provide comments – including responses to key questions posed by the FASB to respondents – on the most significant elements of the Proposed Update, including recommendations that would best position the Proposed Update to deliver decision-useful information to investors.

We summarize those recommendations below:

- 1) ***Abandon “Achievable Standard Setting” in Favor of Effective Standard Setting*** – After investors have waited so many years, we urge the FASB to abandon the notion of “achievable standard setting” and take the time it needs to craft a standard that truly delivers for investors and meets the FASB's objectives as outlined in the SOX Act.
- 2) ***Conduct Technological Capabilities Assessment & Execute Not-for Profit Income Statement Disaggregation Implementation Survey*** – Conduct a survey of leading accounting software providers' capabilities in producing the information needed to disaggregate the financial statements. Conduct a post-implementation review of the amendments to Accounting Standards Codification (“ASC”) Topic 958 (Not-for-Profits Entities) issued in 2016 ([ASU 2016-14](#)) to see how many additional hours and external resources

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<sup>3</sup> Financial Accounting Standards Advisory Council Meeting, September 21, 2023.

were needed by not-for-profit entities to comply with the requirements to disaggregate income statement expenses by nature, which were also disaggregated by program/supporting activity.

- 3) **Require Income Statement Disaggregation by Segment** – Align the presentation of segment expenses with income statement expenses and require the disaggregation and reconciliation of both by their nature. The template for this lies in the disaggregation requirements for not-for-profit entities in ASC 958-205-45-6. Investors value companies by segment. FASB’s recent decision to disaggregate “significant expenses” by segment will only create confusion because of an inability to reconcile disclosure between the overall income statement and segment disclosures.
- 4) **Apply to Public & Private Business Entities** – Widen the scope of the Proposed Update to include all business entities, public and private.
- 5) **Require More Expense Categories to Reduce Balances of “Other” in Disaggregated Expenses** – Add, for disclosure, the following required expense categories based on the FASB’s definition of “natural expense classification” in ASC Topic 958: professional services, occupancy costs other than depreciation, supplies, third-party software, and utilities.
- 6) **Remove Exemption from Disaggregation for Items in Multiple Expense Categories** – Remove the exemption in Paragraph 220-40-50-13 of the Proposed Update for disaggregating certain expense categories if they are in multiple income statement expense captions.
- 7) **Require “Other” Not Exceed 5%** – Require each “other” expense category not exceed 5% of each disaggregated relevant expense caption. In meeting the 5% ceiling, management discretion can be given for defining and breaking out additional categories beyond those required.
- 8) **Require Further Disaggregation of Amortization of Intangibles Expense Similar to Inventory & Manufacturing Expense** – Require the further disaggregation of amortization expense using costs incurred and capitalized to intangible assets, similar to the further disaggregation of inventory and manufacturing expense that disaggregates costs incurred for inventories. This will prevent labor costs capitalized to intangible assets from escaping disclosure, which can be significant for some companies.
- 9) **Capture & Report Payments to Non-Employees Providing Services Similar to Employees** – Create definitions for – and require disclosure of – *non-employees who provide similar services to employees*, such as contract workers and non-employee directors, and *payments to non-employees who provide similar services to employees*.
- 10) **Disaggregate Compensation Costs by Form of Payment** – Require the disaggregation of compensation costs by salaries and wages, payments to non-employees who provide similar services, stock-based compensation, incentive payments, and benefits. Different forms of compensation have different drivers that are relevant to evaluation and modeling.
- 11) **Require Disclosure of Total Human Capital Costs** – Require a dedicated footnote disclosure for “total costs of human capital” – disaggregated by nature from the various functional income statement captions – like what is required under Paragraph 104 in IAS 1, *Presentation of Financial Statements*, except that the scope should be widened to not only include “employee compensation” but also “payments to non-employees who provide similar services to employees.” This will give investors a clear understanding of a company’s labor intensity and sensitivity to risks such as rising wages.
- 12) **Integrate Existing Required and Voluntary Expense Disclosures** – Integrate stock-based compensation, effects of changes in exchange rates, and all other required and voluntary quantitative disclosures related to income statement expense captions into the newly required tabular disaggregation of expenses.
- 13) **Require Disaggregation Tables to Provide Total for Each Type of Expense Disaggregated by Nature** – Require that disaggregation tables to be provided under the Proposed Update also provide a total for each type of expense which has been disaggregated by nature from multiple functional income statement captions. That is, require disclosure of the total amount of each expense category (e.g., employee compensation expense) and its allocation across the income statement expense captions.
- 14) **Require Inventory Rollforward to Contextualize Costs of Goods Sold Disclosures** – Require an inventory rollforward disclosure that reconciles inventory on the balance sheet, costs of goods sold on the income statement, and the disaggregation of costs of goods sold. Captions on the rollforward should match the captions that appear in the disaggregation table. This will alleviate confusion related to the proposed, complex disaggregation of inventory and manufacturing expense captions.

- 15) **Require Disaggregation and Description of “Changes in Inventory” & “Other Reconciling Items and Adjustments” within the Further Disaggregation of Inventory and Manufacturing Expense** – Require disaggregation and description of “changes in inventory” & “other reconciling items and adjustments” within the further disaggregation of inventory and manufacturing expenses. Without explanation and disaggregation these captions will create confusion.
- 16) **Refine Definition of Purchases of Inventory** – Replace the “purchases of inventory” expense category (used in further disaggregation of inventory and manufacturing expense) with “purchases of raw materials” and “purchases of intermediate and finished goods” to better accommodate manufacturing activities.
- 17) **Define Selling Expenses** – The FASB introduces the term “selling expenses” but leaves it up to management to define. An objective of disaggregation is improving investors’ understanding of the nature and behavior of expenses. Introducing a new expense term without defining it and not providing for its disaggregation or its location on the income statement contravenes that objective.
- 18) **Disclose Location of Selling Expenses** – Require the disclosure of selling expenses to include the location of selling expense recognized the income statement. If it is included in multiple expense captions, that allocation must be disclosed.
- 19) **Require Retrospective Adoption for Comparative Periods** – Require retrospective adoption for comparative interim and annual periods after the effective date. For example, if the final standard is effective for calendar year 2025, disaggregated income statement expenses would be presented in the 2025 annual report for 2025, 2024, and 2023 – the current and comparative periods presented on the income statement. Similarly, the first quarterly report (1Q25) should include disaggregated income statement expenses for the current and comparative periods presented: 1Q25 and 1Q24.

### **The Net Result:**

#### **Does Achievable Standard Setting Result in Achievable Analysis & Valuation for Investors?**

Our recommendations are intended to address key issues that imperil the key conceptual elements (e.g., consistency, comparability, understandability, cohesiveness, relevance, etc.) of decision-useful information for investors. In context of the key elements of decision-useful information we highlight why the recommendations are necessary as follows.

**Lack of Consistency in Disaggregation Across Primary Financial Statements, Segments & Disaggregation Footnote: Eliminates Cohesiveness of Financial Statements** – Not providing disaggregation of segment-level expenses– and not requiring alignment in the presentation of expenses across the entity-wide income statement, segment disclosure, and disaggregation footnote – results in a lack of cohesiveness and creates unnecessary confusion limiting the usefulness of disaggregation in modeling and valuation, which are often done at the segment level. (Recommendation #3)

**Lack of Definitions: Reduces Level, Comparability & Meaningfulness of Disclosures** – The lack of, or imprecise nature of, definitions such as selling expenses (Recommendation #18); non-employees who provide similar services to employees (Recommendation #9); and “inventory purchases” (Recommendation #16) within the Proposed Update not only reduces the understandability, decision-usefulness and comparability of disclosures for investors, it actually will result in the elimination or “management” of important disclosures.

**Disaggregation Exclusions, Inconsistency of Disaggregation Principles & Presentation Inconsistencies: Reduces Understandability & Relevance of Disclosures, May Create Confusion & Inaccurate Analysis by Investors on the Nature of a Company’s Expenses** – Investors using financial statements are not likely to have read the FASB’s requirements in the Proposed Update – or any final rules resulting from the Proposed Update. As such, investors are not likely to understand – when reviewing an investee company’s financial statements – the consequences and analytical inconsistencies resulting from the FASB’s complex compendium of decisions. Exclusion of certain items from disaggregation or inconsistent applications of disaggregation principles may not be obvious and may mislead investors. For example, investors may not realize that:

- The expenses required for disaggregation have been arbitrarily determined by the FASB and significant expenses such as professional services, occupancy costs other than depreciation, supplies, third-party software, and utilities are not required to be disclosed. (Recommendation #5)

- Certain expenses have been excluded from disclosure simply because an expense has been allocated to more than one income statement caption. Nor will they realize that the FASB’s rule provides management with an opportunity to avoid disclosure by allocating costs to more than a single financial statement caption. (Recommendation #6)
- Large “other balances” will result throughout the proposed disaggregation tables, limiting the usefulness and predictive capacity of the disclosures. (Recommendation #7)
- The total of employee compensation – as well as the totals for other required disaggregation categories – included within various financial statement captions is not required to be presented. Without presentation of totals across income statement captions<sup>4</sup> it will be unclear to investors if the expense disaggregation is comprehensive. It will also eliminate the ability of investors to see the by nature total of a particular expense for the enterprise. (Recommendation #13)
- The failure to define non-employees who provide similar services to employees will impede the ability of investors to see total human capital costs for the enterprise. (Recommendation #9)
- Employee compensation costs will not be disaggregated by salaries and wages, payments to non-employees who provide similar services, stock-based compensation, incentive payments, and benefits. Different forms of compensation have different drivers that are relevant to evaluation and modeling. (Recommendation #10)
- Lack of a summary of total human capital costs (employee and non-employees) fails to provide investors with an understanding of the company’s labor intensity and sensitivity to risks such as rising wages and provides an opportunity for companies to manage disclosures and contravenes the point of the disclosures. (Recommendation #11)
- Presentation issues such as the failure to define and disclose the location of selling expenses and the need to integrate existing required and voluntary expense disclosures create challenges to understand the nature and location of important expenses. (Recommendations #12, #17 and #18)

***Cost of Sales: Unusual Reconciliations, Lack of Balance Sheet Rollforwards, & Inconsistency in Application Reduces Ability of Investors to Understand & Contextualize Expenses & May Mislead Investors*** – As noted above, investors using financial statements are not likely to have read the FASB’s requirements in the Proposed Update – or any final rules resulting from the Proposed Update – which is likely to create a misunderstanding of disaggregation and presentation choices highlighted in the preceding paragraph. The challenges outlined there become even more challenging when it comes to the FASB’s proposed disclosures related to cost of sales as we note below:

- The further disaggregation of “inventory and manufacturing expense” within cost of sales – and the unusual reconciliation of cost of sales – is likely to result in confusion without greater context, explanation, and disaggregation of “other reconciling items and adjustments” and “changes in inventories.” (Recommendation #15)
- Not providing a rollforward of inventory – including a tabular presentation that reconciles to the income statement – creates, for investors, unnecessary challenges to contextualizing and understanding the aforementioned disaggregation, which can be readily solved by preparers providing a rollforward of inventory. (Recommendation #14)
- The proposed disaggregation of costs of sales for companies without inventory (i.e., all service providers, technology companies such as cloud software and digital media, etc.) is limited and inconsistent with those with inventory. For many of these companies, amortization of intangible assets is a significant, or even majority, component of their cost of sales. Without further disaggregation of amortization, investors will not have a fair view of costs by nature, as labor and other costs capitalized to intangible assets will remain buried in amortization. A large and important sector of the economy should not be ignored and there should not be such a material asymmetry in reporting requirements based on whether a company sells goods vs. services. This results in an asymmetry in reporting requirements in US GAAP. (Recommendation #8)

***Scope Exclusions: Impedes Comparability in Making Investment Decisions*** – Scoping out private business entities from disaggregation while requiring even greater disclosures of disaggregated expenses by not-for-profit entities refutes the FASB’s own cost-benefit analysis and suggests that neither costs, technological barriers, nor user needs are driving the FASB’s decision-making. It also makes comparison between investing in public versus private entities more challenging for investors. (Recommendations #2 and #4)

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<sup>4</sup> See ASC 958-205-55-21 for an example of a tabular reconciliation of income statement expenses by function and nature.

***Prospective Adoption Reduces Comparability & Relevance*** – Finally, prospective adoption, which includes *not* requiring disaggregation for comparative periods presented in financial statements after the effective date, means that investors will have to wait years to accumulate decision-useful information from the Proposed Update which reduces the comparability within and between companies and reduces the relevance of the disaggregation changes. (Recommendation #19)

The inconsistency with segment disaggregation; poorly defined terms; disaggregation exclusions and inconsistencies; presentation differences or challenges; unusual cost of sales reconciliations, missing related balance sheet rollforwards and asymmetry in application to businesses with intangible assets; as well as scope exclusions and lack of comparative information result in manufactured accounting complexity which – as we outline above – not only reduces the decision usefulness of the information but results in analytical complexity for investors. This is accounting complexity investors are not likely to understand as they do not study the detailed provisions of accounting proposals. Without understanding this detailed compendium of complex and inconsistent decisions, the FASB may create a situation where investors misinterpret companies' expenses. Our concern is that achievable standard setting does not likely appear to result in more achievable analytical and valuation work for investors.

Overall, our recommendations are aimed at reducing unnecessary accounting complexity and increasing clarity for investors, through a more straight-forward, complete disaggregation of income statement and segment expenses by their nature, similar to the requirements the Board has created for not-for-profit entities.

## CONTEXT & BACKGROUND TO OUR RESPONSE: APPLE AS AN EXAMPLE OF THE INVESTORS DISAGGREGATION DILEMMA

We begin our comments with a real-world example to illustrate the analytical challenge faced by investors under current reporting standards where disaggregation of revenue and expenses is limited or non-existent.

An investor in Apple Inc.'s (Apple) equity maintains a spreadsheet-based model of Apple's historical and projected income statements, balance sheets, and statements of cash flows.<sup>5</sup> Projected financial statement amounts – operating income, effective tax rate, capital expenditures, depreciation and amortization, and changes in working capital – are inputs to the investor's discounted free-cash-flow-to-the-firm valuation. As a complement, the investor might also use multiples-based valuation, which uses other income statement or statement of cash flow amounts for inputs.

### *Apple's Income Statement Disclosures*

A crucial valuation input is Apple's projected operating income, which is composed of six income statement captions: net sales: products; net sales: services; cost of sales: products; cost of sales: services; R&D expenses; and selling, general, and administrative expenses. **Exhibit 1** shows Apple's income statement for the most recently completed fiscal year and the disclosures both inside and outside the financial statements for each of Apple's income statement captions in its [FY22 Annual Report filed on Form 10-K](#) with the SEC.

As is the case for most issuers, Apple's disclosures for its income statement captions, especially expenses, are scant. Definitions, descriptions, and some quantitative disclosures that disaggregate *revenue* are provided, as is required under ASC Topic 606.<sup>6</sup> In contrast, no disclosures or disaggregation is provided for any *expense*. Investors are not only in the dark regarding the definition and composition of expenses, but also as to whether the expenses are comparable to other companies' expenses with the same captions. **Exhibit 1** summarizes the disclosures for each of Apple's income statement captions.

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<sup>5</sup> We use Apple as an example because it is the largest US-listed company by market capitalization. The issues and challenges illustrated here are not unique to Apple or Apple investors.

<sup>6</sup> ASC 606-10-50-5. "An entity shall disaggregate revenue recognized from contracts with customers into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors."

**Exhibit 1: Apple's Income Statement for Year Ended September 24, 2022 and Related Disclosures**

<b>Caption</b>	<b>Millions of USD</b>	<b>Qualitative Disclosures Provided</b>	<b>Quantitative Disclosures (Disaggregation) Provided</b>
Net Sales: Products	316,199	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ Description of revenue recognition policies</li> <li>▪ “The Company’s proportion of net sales by [product category] was generally consistent for each reportable segment...except in Greater China, where iPhone revenue represented a moderately higher proportion of net sales in 2022 and 2021.”</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ List and brief description of product range</li> <li>▪ Brief discussion of performance vs. prior period.</li> </ul>	<p><u>Notes to Financial Statements:</u> Net sales: Products disaggregated by iPhone, Mac, iPad, and Wearables, Home and Accessories.</p> <p>Total net sales disaggregated by major geography and segment (but not for Net Sales: Products and Net Sales: Services individually).</p> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ Same as Notes to Financial Statements.</li> </ul>
Net Sales: Services	78,129	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ Description of revenue recognition policies.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ List of Services sold.</li> <li>▪ Brief discussion of performance vs. prior period.</li> </ul>	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul>
Cost Of Sales: Products	(201,471)	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ One sentence discussion of performance vs. prior period.</li> </ul>	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul>
Cost Of Sales: Services	(22,075)	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ One sentence discussion of performance vs. prior period.</li> </ul>	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul>
Research And Development	(26,251)	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ One sentence discussion of performance vs. prior period.</li> </ul>	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul>
Selling, General and Administrative	(25,094)	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ One sentence discussion of performance vs. prior period.</li> </ul>	<p><u>Notes to Financial Statements:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul> <p><u>Item 1: Business and Item 7: Management’s Discussion and Analysis:</u></p> <ul style="list-style-type: none"> <li>▪ None.</li> </ul>

Source: Apple Inc. FY22 Annual Report Filed on Form 10-K with the SEC. October 28, 2022.



***Some Detail is Provided in Revenue Disaggregation Disclosures (ASC Topic 606) and Segment Disclosures (ASC Topic 280), But Significant Shortcomings***

Besides the required disaggregated revenue information, Apple also provides segment disclosures, as required under ASC Topic 280, in the notes to the financial statements. These disclosures are reproduced in **Exhibit 2** below.

**Exhibit 2: Apple's Revenue Disaggregation and Segment Disclosures  
(Three Years Ended September 24, 2022)**

**Note 2 – Revenue**

Net sales disaggregated by significant products and services for 2022, 2021 and 2020 were as follows (in millions):

	<b>2022</b>	<b>2021</b>	<b>2020</b>
iPhone	205,489	191,973	137,781
Mac	40,177	35,190	28,622
iPad	29,292	31,862	23,724
Wearables, Home and Accessories	41,241	38,367	30,620
Services	78,129	68,425	53,768
Total net sales	394,328	365,817	274,515

The Company's proportion of net sales by disaggregated revenue source was generally consistent for each reportable segment in Note 11, "Segment Information and Geographic Data" for 2022, 2021 and 2020, except in Greater China, where iPhone revenue represented a moderately higher proportion of net sales in 2022 and 2021.

As of September 24, 2022 and September 25, 2021, the Company had total deferred revenue of \$12.4 billion and \$11.9 billion, respectively. As of September 24, 2022, the Company expects 64% of total deferred revenue to be realized in less than a year, 27% within one-to-two years, 7% within two-to-three years and 2% in greater than three years.

Source: Apple Inc. FY22 Annual Report Filed on Form 10-K with the SEC. October 28, 2022.

**Note 11 – Segment Information and Geographic Data**

	<b>2022</b>	<b>2021</b>	<b>2020</b>
Americas:			
Net sales	169,658	153,306	124,556
Operating income	62,683	53,382	37,722
Europe:			
Net sales	95,118	89,307	68,640
Operating income	35,233	32,505	22,170
Greater China:			
Net sales	74,200	68,366	40,308
Operating income	31,153	28,504	15,261
Japan:			
Net sales	25,977	28,482	21,418
Operating income	12,257	12,798	9,279
Rest of Asia Pacific:			
Net sales	29,375	26,356	19,593
Operating income	11,569	9,817	6,808

Source: Apple Inc. FY22 Annual Report Filed on Form 10-K with the SEC. October 28, 2022.

A reconciliation of the Company's segment operating income to the Consolidated Statements of Operations for 2022, 2021, and 2020 is as follows (in millions):

	<b>2022</b>	<b>2021</b>	<b>2020</b>
Segment operating income	152,895	137,006	91,240
R&D expense	(26,251)	(21,914)	(18,752)
Other corporate expenses, net	(7,207)	(6,143)	(6,200)
Total operating income	119,437	108,949	66,288

The U.S. and China were the only countries that accounted for more than 10% of the Company's net sales in 2022, 2021, and 2020. Net sales for 2022, 2021, 2020 and long-lived assets as of September 24, 2022 and September 25, 2021 were as follows (in millions):

	<b>2022</b>	<b>2021</b>	<b>2020</b>
U.S.	147,859	133,803	109,197
China	74,200	68,366	40,308
Other countries	172,269	163,648	125,010
Total net sales	394,328	365,817	274,515

	<b>2022</b>	<b>2021</b>
U.S.	31,119	28,203
China	7,260	7,521
Other countries	3,738	3,716
Total long-lived assets	42,117	39,440

Source: Apple Inc. FY22 Annual Report Filed on Form 10-K with the SEC. October 28, 2022.

***At This Point, the Investor Has Reached the End of Income Statement Disclosures and Must Carry On, Despite Significant Blind Spots***

The investor must evaluate past performance using, and make forecasts of, highly aggregated quantities of unknown composition. Answers to the following basic questions are among the many unknowns for the Apple investor:

- How much have net sales increased from increasing quantities vs. increasing prices?
- How much have operating expenses increased from increases in output vs. rising costs?
- How exposed is the cost of sales to changes in the prices of commodities?
- How much of each expense line is composed of labor costs, which, based on macroeconomic statistics, have risen rapidly in many geographies?
- Do different segments have different gross margins?
- Do different products have different levels of operating profitability?
- How much have gross margins changed from changes in input costs, like commodities and labor, vs. changes in selling prices and product mix?
- Do certain product lines account for a disproportionate share of research and development and selling expenses vs. their contribution to revenue or gross profit?
- Services appear to have much higher gross margin than products (71.7% vs. 36.3%). Do they also have higher operating profit margins, or are they disproportionately costly below the cost of sales lines?

This degree of opacity is not unique to Apple. Rather, the opacity reflects the limited disclosure requirements under US GAAP. SEC regulations provide investors with more transparency by issuers in certain industries like banking, but not in most sectors.<sup>7</sup> With scant disclosure of information, key tasks for investors are made very challenging or impossible, including the following.

<sup>7</sup> See *Statistical disclosure by bank holding companies* in the [SEC's Industry Guides](#).

*Making Projections & Performing Scenario Analyses* – Investors form investment theses shaped by their research and discretionary views. Investment theses are used in investors’ quantitative projections in financial statement and valuation models. For example, the Apple investor’s forecasts of Apple’s income statement on either an entity-wide or segment basis (usually both) would be driven by their investment thesis.

The ability of an investor to develop and quantify a thesis is limited to the extent and timeliness of issuer disclosures. Consider the following basic investment theses for Apple:

- The supply of components is increasingly limited by the scarcity of suppliers who can provide leading edge technologies, geopolitical tensions, and increases in the cost of raw materials and skilled labor. Component costs for Apple will increase, posing a risk to profitability as Apple’s ability to increase prices is limited in some markets.
- Based on their research that shows how often smartphones are used and how much value they deliver, an Apple investor hypothesizes that consumers will increasingly demand more premium iPhones and that iPhone prices will be increased, primarily in developed markets. More premium iPhones and higher selling prices will increase both revenue and profitability.
- Based on comparisons to other companies that sell digital advertising and subscription-based digital services, services revenue will grow strongly as both Apple’s installed base and average services revenue per user grow. However, this will come with lower profitability; the SG&A, R&D, and CAPEX intensity of competitor and peer companies in digital services are high.

Virtually none of the historical numbers needed to support the quantification of these scenarios/theses are disclosed, as they are buried within aggregated captions. Making projections based on these scenarios is impossible without making assumptions or using third-party figures that are prone to error and available only to a privileged set of investors.

Segment reporting helps, but segment numbers are not sufficiently disaggregated, nor are they reconciled with revenue disaggregation disclosures under ASC Topic 606, and segment operating expenses (i.e., segment revenue – segment operating income) are not reconciled with expenses presented on the income statement. Investors cannot evaluate or forecast gross margin, SG&A, or R&D expenses by segment.

Some companies disclose more disaggregated information on a voluntary basis. Sometimes it is reconciled with segment and financial statement amounts. We are grateful for that, but a voluntary disclosure regime poses many problems for investors. Voluntary disclosures are:

- *At the Discretion of Management* – Non-GAAP disclosures can change form and content without notice, or simply be discontinued. For example, in 2018, Apple discontinued disclosure of unit volumes as management asserted that unit volumes were no longer as relevant as they were in the past.<sup>8</sup> This also resulted in the discontinuation of the disclosure of implied average selling prices.

The same is true for reporting segments, which are required but highly discretionary in their application. IBM, for example, changed its reporting segments in 2022, 2021, 2020, 2019, 2016, and 2011.<sup>9</sup> Investors’ ability to observe trends and make inferences is severely challenged by the instability of voluntary, discretionary measures. Management has obvious incentives to disclose positive information and withhold negative information.

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<sup>8</sup> Unit sales is “not representative of underlying strength of our business,” Apple CFO Maestri said. “A unit of sale is less relevant today than it was in our past,” while saying that unit sales increase are still a clear part of Apple’s goals. CEO Cook adds “This is a little bit like if you go to the supermarket and you push your cart up to the cashier and [they say] ‘How many units you have in there?’ It doesn’t matter a lot how many units are in there in terms of the overall value of what’s in the cart.”

<sup>9</sup> IBM Annual Reports filed on Form 10-K with the SEC.

- *Not Comparable* – Other companies, even industry peers, may not make the same disclosures or use the same scope and accounting policies, even for amounts with the same captions. The well-known example is “Adjusted EBITDA,” which has as many definitions as companies reporting the metric, but even SG&A or R&D expenses are not uniformly defined.
- *Often Not Reconcilable to Financial Statement Quantities* – For example, several US retailers over the last few years have made headlines by significantly increasing hourly pay for store, warehouse, and logistics employees.<sup>10</sup> Some other retailers have had to make surprisingly large investments in payroll to keep up and ensure appropriate staffing. Most companies do not disclose labor costs in total or by functional area. When Dollar General reported to investors that it has increased its outlook for store-level investments this year, primarily in retail labor, to \$170 million<sup>11</sup>, the location of that investment on the financial statements (i.e., SG&A or cost of sales) is not disclosed. Investors must use third-party data, which has accuracy problems, to try to estimate, for example, if a company’s wages are materially lower than its industry peers, which would pose clear risks to staffing.
- *Often Not Timely* – The volume of voluntary disclosures from management is often highest on an annual basis or longer, such as at inventory/analyst days and in investor presentations.
- *Not Audited* – Disclosures made outside the financial statements and notes are not independently audited.

*Another Key Challenge: Verifying Management’s Qualitative Statements* – In virtually all earnings calls, management makes comments about important disaggregated revenue and expense information in their prepared remarks or in response to analysts’ questions. ***It is often impossible for an investor to verify management commentary using disclosures required under US GAAP or even provided voluntarily in securities filings.***

Continuing with the Apple example, **Exhibits 3 – 6** which follow show management commentary, drawn from the company’s last two earnings calls, and illustrate the challenge for investors in evaluating that commentary.

**Exhibit 3:**

<p><i>Management Commentary:</i> “The 44.5% [gross margin] for the June quarter is an all-time record for us in June. We were up 20 basis points sequentially. It was driven by cost savings and a mix shift towards services, which obviously helps company gross margins, partially offset by the seasonal loss of leverage. We have a commodity environment that is favorable to us. Our product mix is quite strong at this point.”</p>
<p><i>The Investor Challenge:</i> Why this cannot be verified or reconciled by investors:</p> <ul style="list-style-type: none"> <li>▪ The exposure of commodities cost component or exposure in cost of sales is not disclosed.</li> <li>▪ The product mix of gross margins is not disclosed.</li> <li>▪ The impact of changes in USD exchange rates on gross margin is not disclosed.</li> </ul>
<p><i>Analyst Follow-Up Question:</i> “Going back to the gross margin line. Pretty good guidance into this March quarter. I’m curious if you unpack that a little bit specific around what you’re seeing as far as may be benefits from component pricing in the guidance, if you’re embedding any of that at this point.”</p> <p><i>Management Response:</i> “Yes. Of course, with our guidance, we try to capture every aspect of our cost structure. And obviously, components are a big portion of that. So definitely, that’s included.”</p>
<p><i>The Investor Challenge:</i> Why this cannot be verified or reconciled by investors: The composition of cost of sales is not disclosed, including the amount that is “components,” which evidently is a significant portion of cost of sales.</p>

<sup>10</sup> [Walmart to raise average hourly wage to more than \\$17.50 an hour \(nbcnews.com\)](https://www.nbcnews.com/tech/walmart-raise-average-hourly-wage-more-than-17-50-an-hour-nbcnews.com)

<sup>11</sup> [Dollar General Corporation Reports Second Quarter 2023 Results.](https://www.dollargeneral.com/investor-relations/press-releases/2023/02/dollar-general-reports-second-quarter-2023-results)

#### Exhibit 4:

*Management Commentary:* “[W]e decided to be deliberate in what we do in terms of controlling our spend, and there’s many areas across the company that we’re working on and we’ve been quite effective at slowing down the spend. We slowed down also the hiring within the company in several areas. And we’re very pleased with our ability to decelerate some of the expense growth taking into account the overall macro situation.”

*The Investor Challenge:* Why this cannot be verified or reconciled by investors:

- Headcount is disclosed on an annual, not quarterly basis.
- Headcount by functional area is not disclosed.
- Payroll costs are not disclosed.

#### Exhibit 5:

*Analyst Question:* “You clearly emphasize the focus and importance of the installed base. If we think about the absolute growth of the installed base from 1 billion to 2 billion over 7 years from a device standpoint, how should we think about the penetration of services or the growth in paying customers on services or that time frame? Is that penetration rate increasing or decreasing? How fast is that growing relative to the growth of the overall installed base?”

*Management Response:* “Yes, of course, we keep track of that. It’s really important for us. Over the last seven years, as we doubled the installed base, we’ve seen a growing engagement of our customers on the platform. That happens, first of all, by customers transacting on the platform and then moving to paid accounts. So, starting to pay for some of the services. That percentage of paid accounts tends to grow over time... So, to your question, of course, higher engagement means a higher percentage of paid accounts over time.”

*The Investor Challenge:* Why this cannot be verified or reconciled by investors:

- Installed base is not disclosed in filings.
- Percentage of device users using or pay for Services (“penetration rate” of Services) is not disclosed.
- Number of Services accounts (paid or free) is not disclosed.

#### Exhibit 6:

*Analyst Question:* “[Can] you could update us on what percent of iPhones are sold on some type of installment basis now versus full upfront payment on a global basis. And maybe some thoughts on if you expect similar promotional activity from carriers, especially in the U.S., that seem to be grappling with a lot of cash flow issues this particular year.”

*Management Response:* “The majority of iPhones, at this point, are sold using some kind of a program, trade-ins, installments, some kind of financing. And that percentage, which again, it’s well over 50%, is very similar across developed and emerging markets. We want to do more of that because we think it really helps reduce the affordability threshold for our products. And we think it is also one of the reasons why our product mix has been very strong during the last couple of cycles. So we will continue to push on that front.”

*The Investor Challenge:* Why this cannot be verified or reconciled by investors:

- Installment vs. upfront sales mix of products to end-users is not disclosed.
- Product sales mix of trade-in or other incentive program for upgrades is not disclosed.
- Net sales mix by “Emerging Markets” and “Developed Markets” is not disclosed.

Sources: Apple Inc. FY23 Q3 and Q2 earnings conference calls, accessed via [Seeking Alpha](#)

## **CONTEXT & BACKGROUND TO OUR RESPONSE: BRIEF HISTORY OF OUR ADVOCACY ON DISAGGREGATION**

The challenges faced by the investor in the preceding example are not new. Investors have consistently expressed their need for more disaggregated and cohesive financial information since before the FASB's inception in 1973. A disaggregation project (segments) was on the FASB's first technical agenda,<sup>12</sup> and as the Proposed Update describes, the FASB has considered disaggregation and presentation projects several times, including in 2008 and 2010. Investors' needs did not ebb with the passage of time, as disaggregation was rated a top priority by investors in both the FASB's 2016 and 2021 Agenda Consultations. The cost of producing and disclosing information, however, has declined exponentially over this time, thanks to the information technology revolution.

***Our Views on Disaggregation Circa 1990: Greater Disaggregation Necessary*** – As we wrote in our 1993 publication *Financial Reporting in the 1990s and Beyond*:

*“Financial analysts have consistently over the years requested financial statement data disaggregated to a much greater degree than it is now...The need [for disaggregated financial data] is more than ‘necessary.’ It is vital, essential, fundamental, indispensable, and integral to the investment analysis process...Without disaggregation, there is no sensible way to predict the overall amounts, timing, or risks of a complete enterprise’s future cash flows.”<sup>13</sup>*

The core problem is that financial statements, particularly the income statement and operating section of the statement of cash flows prepared using the indirect method, present highly aggregated quantities of unknown composition.

***Our Views on Disaggregation Circa 2007: Nature over Function*** – We have advocated for income statement expenses presented or disaggregated by nature, rather than function, for many years. A natural expense classification enhances comparability and understandability. A “salaries and wages” expense caption, for example, is intuitive, clearly related to labor hours and pay rates as drivers and is comparable to another company’s expense with that same caption. A “selling, general, and administrative” expense caption, in contrast, contains various types of expenses, is defined by each company’s management, and is thus not comparable between companies.

Presentation and disaggregation of income statement expenses by nature is one of the key principles in our 2007 publication [\*A Comprehensive Business Reporting Model: Financial Reporting for Investors\*](#):

***Principle:*** *Individual line items should be reported based upon the nature of the items rather than the function for which they are used.*

***Reasons for Importance:*** *The forecasting of individual line items for use in valuation and other decisions requires that they be relatively homogeneous—that is, represent a single economic attribute or an aggregation of very similar attributes. For example, rather than following the current practice of aggregating labor cost, pension costs, raw materials, energy costs, overhead allocations, and the like, into cost of goods sold, which mixes items of very different economic characteristics, trends, and measurement bases, the individual categories should be reported. Indeed, investors currently expend much effort to disaggregate such numbers. Because of the limited information available, the*

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<sup>12</sup> Financial Accounting Standards Board (1976), Statement of Financial Accounting Standards No. 14: *Financial Reporting for Segments of a Business Enterprise*, Paragraph 47. See also Paragraphs 42-46 for a brief discussion of investor support for disaggregation from the mid-1960 onward.

<sup>13</sup> Association for Investment Management and Research (1993), *Financial Reporting in the 1990s and Beyond*.

*calculations require much estimation and result in considerable error, thus affecting the usefulness of the information. Companies reporting under [IFRS] are permitted to report expenses based on either function or nature. So, this is not a new concept.*

**Current Practice:** *Information in financial statements, particularly in the income statement but also, to a lesser degree in the balance sheet, is aggregated in major functional categories, such as cost of goods sold and selling, general, and administrative activities. This practice began long ago when companies tended to be focused in a single industry or activity and the items aggregated were more nearly homogeneous. Such is not the case today.*<sup>14</sup>

**Another Key Shortcoming of Financial Statement Presentation: Lack of Cohesiveness** – In addition to advocating for disaggregation, we have long advocated for transparent cohesion across financial statements through disclosure of rollforwards that clearly show the relationship between balance sheet accounts and the related income statement and statement of cash flows captions. Today, these relationships are obscured; for example, the “change in inventories” caption on statements of cash flows rarely match the difference between the beginning and ending inventories reported on the balance sheet. As we wrote in [A Comprehensive Business Reporting Model: Financial Reporting for Investors](#):

*Financial statements articulate; that is, items in the statements...flow from one to another and should be traceable and directly observable by investors. Indeed, the knowledge gained from analyzing such flows is critical to an investor’s understanding of a company’s value-generation process.*

*Currently... this articulation is at best obscured, making it impossible for even the most skilled investor to dissect this articulation in order to perform a thorough analysis. The articulation is hidden by (1) the very different and inconsistent aggregation and netting processes in the various statements and (2) the impossibility of directly comparing the operating section of the indirect method cash flow statement with the income statement or the investing and financing sections with changes in the balance sheet.*

*The analysis required to even approximate a direct method cash flow statement from the available data is difficult and time consuming. **The real challenge, however, is not the enormous effort required but rather the fact that the articulation between the balance sheet and the income statement is almost always obscured.***

*For example, most companies provide insufficient information to permit a skilled analyst to cleanly decompose the entries affecting accounts receivable and to determine cash inflows from sales, the amounts of cash collected from customers. Gross estimates must be made, greatly reducing the reliability and usefulness of the information generated by the exercise. The same is true to a greater or lesser extent for all of the other numbers in a direct method statement. In addition, it is often impossible to align the adjustments in the indirect method cash flow statement with any single income statement line item.*

**Need for Greater Disaggregation and Cohesiveness Fundamental to the FASB’s Late 2000s Project on Financial Statement Presentation** – The Board’s joint 2008 Discussion Paper with the International Accounting Standards Board (“IASB”), *Preliminary Views on Financial Statement Presentation*, proposed numerous changes to the financial statement presentation model motivated by two high-level issues:

**1) Information is not presented consistently in financial statements –**

*Transactions or events recognized in financial statements today are not described or classified in the same way in each of the statements. That makes it difficult for users to understand how the information in one statement relates to information in the other statements. For example, the Boards’ standards on the statement of cash flows require a section for operating activities, but International Financial Reporting Standards (IFRSs) and U.S. GAAP do not provide a section for operating activities in the statement of comprehensive income or the statement of financial position. That makes it difficult, for example, for users who want to assess the quality of an entity’s earnings by comparing operating income with operating cash flows. **Even though financial statements sometimes articulate at a high level (for***

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<sup>14</sup> CFA Institute (2007), *A Comprehensive Business Reporting Model: Financial Reporting for Investors*, Page 59.

*example, the change in the cash account relates to the statement of cash flows), users have asked for improved linkages between and among statements.”<sup>15</sup>*

**2) Information is not sufficiently disaggregated in financial statements –**

*Even though IAS 1 and Regulation S-X address presentation issues, IFRSs and U.S. GAAP provide little specific guidance on the presentation of line items in financial statements, such as the level of detail or number of line items that should be presented. The resulting **variation and inconsistency in presentation formats create difficulties for users who want to understand and analyze an entity’s activities**. For example, some entities disaggregate direct product costs (such as materials and labor) as well as general and administrative costs (such as rent and utilities) in their statement of comprehensive income. However, other entities present both product costs and general and administrative costs in the aggregate. Such **aggregation makes it difficult for users to study the relationship between revenue and costs for an entity’s principal activities as well as to perform a benchmark analysis of those activities across an industry**.*

***Insufficient disaggregation also makes it more difficult for users to understand how a line item in one financial statement relates to the other financial statements**. For example, consider an entity that presents its research and development expenses on a single line in its statement of comprehensive income. If that entity aggregates the cash outflows related to its research and development activities with “other” or “general” operating cash outflows in its statement of cash flows, it would be difficult for a user to understand the cash demands of the entity’s research and development efforts.<sup>16</sup>*

In response, the Board and the IASB proposed requiring entities to present revenues, expenses, gains, and losses by operating, investing, and financing categories and then disaggregate the captions within those categories by their function and nature. While the Board and IASB “initially expressed a preference for presenting information in the statement of comprehensive income by function...users of financial statements told the Boards that although [functional] disaggregation assists in the analysis of overall business trends (such as in gross margins and operating margins), it aggregates items with different economic drivers (for example, labor and raw materials) and thus reduces the predictive value of the information. Therefore, the Boards propose disaggregating the by-function information within the categories by nature as well.”<sup>17</sup>

We strongly supported these and other proposed changes in our 2009 comment letter:

*We support the disaggregation of the income statement by nature and function, rather than only by function. This will allow managers to provide a relevant and informative depiction of performance. It will significantly increase the usefulness, attribution and predictability of future earnings and cash flows. In the Comprehensive Business Reporting Model (CBRM-page 14) we advocate the display of items by nature. Categorization by nature enhances the comparability across companies and consistency within the statements of a single company. On the other hand, aggregation by function obfuscates the recording of key items. Currently, users of financial statements cannot determine from the statements or related disclosures where individual items, such as pension expense and depreciation, are recorded in the income statement.<sup>18</sup>*

***We Recommended Several Improvements to the Board’s Segment Disclosures***

***Improvement Project*** – Segment reporting under ASC Topic 280 is one of the few required disclosures of disaggregated information in US GAAP. Management’s allocation of revenues and certain operating expenses to reported segments helps investors better understand the components of a company and forecast those components individually. Investors value segment disclosures greatly. In fact, in our 2018 member survey and paper on segment

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<sup>15</sup> Financial Accounting Standards Board. *Preliminary Views on Financial Statement Presentation*. October 16, 2008. Paragraph 1.11.

<sup>16</sup> *Ibid.* Paragraphs 1.14-15.

<sup>17</sup> *Ibid.* Paragraph 3.51.

<sup>18</sup> CFA Institute. Comment Letter on Preliminary Views on Financial Statement Presentation. April 14, 2009.



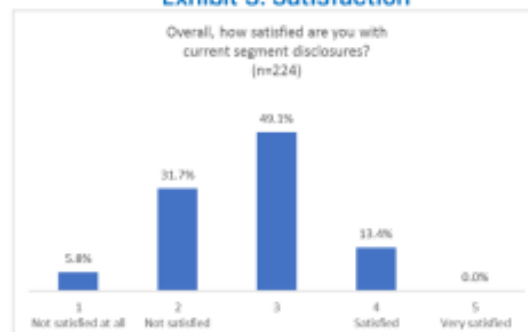
reporting, [Segment Disclosures: Investor Perspectives](#), most responded that segment reporting is more or equally important than entity-wide disclosures.

- Importance versus satisfaction**—For investors, 75% rate segment disclosures as very important to their analysis (see **Exhibit 1**, reproduced below from the full report). The respondents rate segment disclosures as equally, 58.7%, if not more important, 31.4%, for a total of 90.1%, than entity-wide disclosures (see **Exhibit 2**, reproduced below from the full report). That said, their satisfaction, 13.4%, with the segment disclosures is substantially less (see **Exhibit 3**, reproduced below from the full report) than their rating of the importance of segment disclosures. The implication for standard-setters is that there is substantial work to be done to meet segment disclosure investor needs.

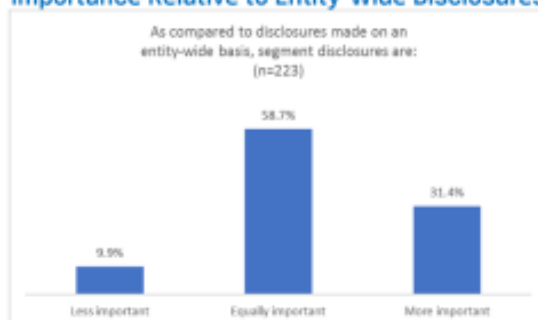
**Exhibit 1: Importance**



**Exhibit 3: Satisfaction**



**Exhibit 2: Importance Relative to Entity-Wide Disclosures**



Segment reporting, however, has several shortcomings, which is reflected in investors’ relatively low satisfaction with segment disclosures; only 13.4% of members in our survey were “satisfied” and 0% were “very satisfied” with the current segment disclosures. These shortcomings were the impetus for the FASB’s revisiting segment disclosures and proposing [Improvements in Reportable Segment Disclosures](#) in late 2022.

Our [comment letter](#) in early 2023 explained in detail how and why the proposed amendments fell far short of the improvements investors sought in segment reporting. We also noted our concern regarding the coordination of the segment project with the Proposed Update as follows:

***Coordination with Other Standards** – Finally, at the heart of this project is the concept of greater disaggregation. Disaggregation is a concept also integral to the income statement presentation project and the tax disclosures project – both of which impact segments. To that end, our question is whether and how the changes between the projects are being orchestrated and coordinated and what disaggregation principles are underpinning and cross cutting these proposed changes.*

## **CONTEXT & BACKGROUND TO OUR RESPONSE: ACADEMIC RESEARCH**

Academic research confirms the utility of disaggregated information: greater disaggregation leads to more accurate forecasts by investors and, in turn, more appropriate securities pricing by capital markets.

Investors are not harmed by more information or the supposed “complexity” of disaggregated information. Several papers, some especially well known, have established the benefits of disaggregated information in its confirmatory and predictive value. Examples include:

- Burke, Warfield, and Wieland (2020) utilize bank holding companies’ volume and rate analyses, which is a uniquely useful set of disclosures required in MD&A by the SEC’s *Statistical Disclosure by Bank Holding Companies* since 1990. The authors find that volume and rate variances are predictive of future net interest income and are positively associated with stock returns and prices, suggesting the disaggregated information is value relevant.
- Chen, Miao, and Shevlin (2015) find that greater disaggregation of income statement and balance sheet items is positively associated with higher analyst forecast accuracy of earnings and associated with lower costs of equity.
- Hirst, Koonce, and Venkataraman (2007) find that disaggregation enhances the credibility of management forecasts by investors through three factors: perceived precision of management's beliefs, perceived clarity of the forecast, and perceived financial reporting quality. The study shows that management can most effectively communicate their expectations about the future to investors with more granular disaggregation.
- Board member Botosan (1997) finds that greater volume of disclosures is associated with lower costs of equity, particularly for firms without high analyst following. The magnitude of the effect was found to be a one-unit increase in disclosure volume was associated with a 28-basis point reduction in the cost of equity.
- Fairfield, Sweeney, and Yohn (1996) find that net income disaggregation into its constituent parts improves profitability forecasts. Besides the disaggregation of extraordinary items and discontinued operations, disaggregation into operating, non-operating, income taxes, and special items provides further predictive value.

## SUMMARY OF PROPOSED UPDATE

For the sake of reference, and for our members and investors less familiar with the Proposed Update reading this comment letter, we summarize the proposed changes using an example provided by the FASB.<sup>19</sup> The Proposed Update requires public business entities to do the following.

### *Identify Expenses on The Income Statement to Be Disaggregated (i.e., Identify The “Relevant Expense Captions”)*

These are expense captions that contain any of the following expense categories:

- *Inventory and Manufacturing Expense.* This is similar to cost of goods sold but is a combination of two new terms: “inventory expense” and “manufacturing expense.” The FASB defines inventory expense as one resulting from the sale, consumption, or impairment of inventory, while leaving management to define other “manufacturing expense.”
- *Employee Compensation.* This is another new term that includes all forms of cash, stock, and in-kind benefits paid to employees in exchange for services or upon termination.
- *Depreciation.*
- *Intangible Asset Amortization.*
- *Depreciation, Depletion, and Amortization (DD&A)* related to oil- and gas production.

For example, Manufacturing Co. is a hypothetical manufacturer with some service operations. The company’s consolidated income statement for the years ended 31 December 20X3, 20X2, and 20X1 is as follows:

<b>Manufacturing Co.</b>			
<b>Consolidated Income Statement</b>			
<b>For the Years Ended December 31, 20X3, 20X2, and 20X1</b>			
	<b>20X3</b>	<b>20X2</b>	<b>20X1</b>
Revenues:			
Products	82,144	79,137	75,180
Services	26,132	23,146	21,989
Total revenues	108,276	102,283	97,169
Cost of products sold	63,456	60,898	57,244
Cost of services	10,496	9,568	8,898
Gross profit	34,324	31,817	31,027
Selling, general, and administrative	20,849	18,871	18,116
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

Manufacturing Co. identifies *cost of products sold*, *cost of services*, and *selling, general, and administrative* expenses for disaggregation because they each contain at least one of inventory and manufacturing expense, employee compensation, depreciation, amortization, or DD&A. The company does not identify *interest expense* or *income tax expense* for disaggregation because they do not contain any of the specified types of expense.

<sup>19</sup> For a more in-depth summary and our preliminary views, see our September, 2023 blog post [FASB Exposure Draft on Disaggregation of Income Statement Expense: A Glass Half Empty](#)

### *Disaggregate The Identified Relevant Expense Captions*

Next, the relevant expense captions are disaggregated by the expense categories in tabular format in the notes to the financial statements.

- Certain amounts that already must be disclosed under US GAAP would also be required to be broken out, subject to certain conditions. These are included in a prescriptive list in paragraphs 250-40-50-12 and 250-40-50-13 of the Proposed Update.
- Some other costs — warranty expenses, impairment charges, and exit/disposal costs, for example — are also broken out in the disaggregation tables. Others, such as operating lease costs, would only have to be broken out if they are contained solely in one expense caption. If they are in multiple expense caption (e.g., operating lease costs in both cost of sales and SG&A), disaggregation would not be required.
- Any remaining amounts in the relevant expense captions after disaggregation into the specified categories would be grouped into an “other” line, which is described qualitatively.

For example, Manufacturing Co. would disclose the following disaggregation tables for *cost of products sold*, *cost of services*, and *selling, general, and administrative* expenses in the notes to the financial statements.

<b>Cost of products sold</b>	<b>20X3</b>	<b>20X2</b>	<b>20X1</b>
Inventory and manufacturing expense	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	1,933	1,873	2,159
<b>Total cost of products sold</b>	<b>63,456</b>	<b>60,898</b>	<b>57,244</b>

“Other cost of products sold” consisted primarily of amounts paid to carriers for freight services related to contract fulfillment for the years ended 31 December 20X3, 20X2, and 20X1.

<b>Cost of services</b>	<b>20X3</b>	<b>20X2</b>	<b>20X1</b>
Employee compensation	6,598	5,654	4,354
Depreciation	763	765	742
Intangible asset amortization	642	670	650
Other cost of services	2,493	2,479	3,152
<b>Total cost of services</b>	<b>10,496</b>	<b>9,568</b>	<b>8,898</b>

“Other cost of services” consisted primarily of operating lease and travel costs for the years ended 31 December 20X3, 20X2, and 20X1.

<b>Selling, general, and administrative</b>	<b>20X3</b>	<b>20X2</b>	<b>20X1</b>
Employee compensation	13,242	11,379	10,764
Depreciation	1,454	1,755	1,737
PP&E impairment	412	0	0
Intangible asset amortization	523	596	0
Other SG&A	5,218	5,141	5,615
<b>Total selling, general, and administrative</b>	<b>20,849</b>	<b>18,871</b>	<b>18,116</b>

“Other SG&A” consisted primarily of professional services fees, operating lease expense, and the costs paid to third parties for printing, publications, and advertising for the years ended 31 December 20X3, 20X2, and 20X1.

Notice that “Other” in this example ranges in materiality by expense line. In 20X3, “other cost of products sold” represented 3% of cost of products sold, while “other SG&A” represented 25% of total SG&A. The size of “other” lines will vary based on an issuer’s expense composition vs. the expense categories specified by the Board.

***Further Disaggregate “Inventory and Manufacturing Expense,”  
Contained Within Cost Of Sales***

“Inventory and manufacturing expense” is a combination of two new terms, “inventory expense,” which the Board defined as expense resulting from the sale, consumption, or impairment of inventory, and “other manufacturing expense,” which will be defined by management.

- Inventory and manufacturing expense are disaggregated into the following categories of costs incurred: purchases of inventory, employee compensation, depreciation, intangible asset amortization, and DD&A.
- Costs incurred would include those that are either capitalized to inventory or directly expensed during the current period.
- On an annual basis, the company would disclose its definition of other manufacturing expenses.

For example, Manufacturing Co. discloses the following additional table in the notes to the financial statements:

<b>Inventory and manufacturing expense</b>	<b>20X3</b>	<b>20X2</b>	<b>20X1</b>
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	5,619	5,733	5,834
<b>Total inventory and manufacturing costs</b>	<b>54,073</b>	<b>52,372</b>	<b>47,299</b>
Other adjustments and reconciling items	(542)	424	538
Changes in inventories	157	(861)	843
<b>Total inventory and manufacturing expense</b>	<b>53,688</b>	<b>51,935</b>	<b>48,680</b>

The Board has chosen to require disaggregation under a “costs incurred” (costs that flow into the balance sheet as inventory) approach, not an “expense recognized” (i.e., costs that flow out upon sale) approach. The lines “change in inventories” and “other adjustments and reconciling items” are used to reconcile inventory and manufacturing *costs* with inventory and manufacturing *expenses*.

“Change in inventories” equals the difference between beginning inventories from ending inventories on the balance sheet. An increase or decrease in inventories results from changes in customer demand, inflation, inventory obsolescence, seasonality of purchases vs. sales, and other factors. “Other adjustments and reconciling items” captures differences in the changes in inventories vs. inventory expenses recognized, including inventory impairments, inventory disposed or acquired in a business combination, and FX translations. “Other adjustments and reconciling items” will be described qualitatively by management.

The Board chose the “costs incurred” approach to reduce implementation and system costs, citing the use of standard costs and cost flow assumptions by preparers and because some costs may have been capitalized to inventory many years ago.

### ***Define And Disclose Selling Expenses***

The final requirement is a definition and disclosure of selling expenses in the notes to the financial statements. Management will define selling expenses annually but is not required to disclose the location of selling expenses on the face of the income statement. For companies that present SG&A on the income statement, selling expenses are presumably in that caption, allowing investors to calculate G&A (i.e., SG&A minus selling expenses).

For example, Manufacturing Co. would disclose the following:

During the years ended 31 December 20X3, 20X2, and 20X1, Manufacturing Co.'s selling expenses, which include those related to marketing, promotional activities, and client relationship management, were \$13,425, \$12,123, and \$11,585, respectively.

### ***Definitions Of "Employee" And "Employee Compensation"***

In connection with the requirement to disaggregate "employee compensation," the Proposed Update leverages the existing definition of "employee" from the ASC topic on stock-based compensation and adds a new definition of "employee compensation" to the Master Glossary.

- An "employee" is defined as "an individual over whom the reporting entity exercises or has the right to exercise sufficient control to establish an employer-employee relationship based on common law as illustrated in case law and U.S. Internal Revenue Service rules. A reporting entity based in a foreign jurisdiction would determine whether an employee-employer relationship exists based on the pertinent laws of that jurisdiction."
- "Employee compensation" is defined as "all forms of cash consideration (including deferred cash compensation), share-based payment arrangements, medical care benefits, pension benefits, postretirement benefits, and nonretirement postemployment benefits (including special or contractual termination benefits) given by an entity in exchange for service rendered by employees or for the termination of employment. This includes compensation cost arising from wages, salaries, social security contributions, profit-sharing, bonuses, one-time employee termination benefits, other postemployment benefits, employee stock ownership plans, employee share purchase plans, defined contribution plans, multiemployer plans, and any other compensation cost recognized in accordance with the guidance in Topic 710 on compensation. For defined benefit plans within the scope of Topic 715 on retirement benefits, employee compensation includes only the service cost component of net periodic pension cost and the service cost component of net periodic postretirement benefit cost."

Source: Proposed Update.

## OBSERVATIONS AND RECOMMENDATIONS RELATED TO PROPOSED UPDATE

We reviewed the Proposed Update and considered the questions posed to respondents. We provide our high-level observations, answers to specific questions, and recommendations to the Board to improve the decision-usefulness of the Proposed Update for investors below. We note the question numbers where applicable. We did not respond to all the questions as some were applicable principally to preparers or practitioners.<sup>20</sup>

### *No Interaction with Segment Reporting*

The expense disaggregation in the Proposed Update will not be required at the segment level, nor will “significant expenses” by segment – as proposed by the Board in [Improvements in Reportable Segment Disclosures](#) – be reconciled to expenses presented on the income statement or in the disaggregation footnote.

The Proposed Update and the proposed amendments to segment disclosures are completely disconnected. Investors will be left to try to reconcile the consolidated income statement, segment disclosures, disaggregated income statement expense footnote, and any related non-GAAP measures with one another. Investors will have pieces to the puzzle, but no clues as to how they fit together.

No reconciliation between segment expenses and disaggregated income statement expenses impairs the decision-usefulness of the Proposed Update because investors evaluate and value most companies at the segment level. As indicated in our aforementioned [2018 member survey](#), investors find segment disclosures to be as or even more valuable than entity-wide disclosures.

We urge the Board to require the disaggregation of segment operating expenses and their reconciliation with disaggregated income statement expenses. The template for this lies in the disaggregation requirements for not-for-profit entities that the Board issued in 2016.

<i>Recommendation:</i> Included within the next item.
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<sup>20</sup> We did not respond to Questions 1, 4, 5, 9, 10, 11 and 18.

### Greater Disaggregation is Possible: Not-for-Profits Since 2016

Since 2016, all not-for-profits must disaggregate income statement expenses by type of program and supporting activity (which resembles a break down by segment)<sup>21</sup> and the nature of the expense, which is not arbitrarily limited to several natural expense categories like the Proposed Update. The disaggregation in the notes to the financial statements are fully reconciled and cross-foot with the expenses presented on the income statement. In other words, users can see the *total* for each expense by nature (e.g., total salaries and wages, and its allocation to the income statement captions).

For example, in its [2022 annual report](#), the Financial Accounting Foundation – the FASB’s not-for-profit parent entity – broke down its income statement expenses according to their nature and by program and supporting activity in the notes to the financial statements. This is more granular and decision-useful than what the Proposed Update would require of public business entities.

4. Program and Support Expenses							
The following table presents expenses by both their nature and functions for the years ended December 31, 2022 and 2021 (dollars in thousands):							
Year ended December 31, 2022	Program			Publishing	Total Program	Support	Total Expenses
	Standard-Setting		Total				
	FASB	GASB					
Salaries and wages	\$22,034	\$6,604	\$28,638	\$1,961	\$30,599	\$5,191	\$35,790
Employee benefits	5,349	1,498	6,847	491	7,338	1,598	8,936
Occupancy and equipment expenses	1,552	503	2,055	186	2,241	773	3,014
Depreciation and amortization	819	216	1,035	2,727	3,762	258	4,020
Information technology fees	1,042	235	1,277	2,914	4,191	439	4,630
Professional fees—other	1,087	305	1,392	29	1,421	3,062	4,483
Printing and shipping	–	–	–	148	148	–	148
Other operating expenses	1,015	479	1,494	70	1,564	1,675	3,239
<b>Total operating program and support expenses</b>	<b>32,898</b>	<b>9,840</b>	<b>42,738</b>	<b>8,526</b>	<b>51,264</b>	<b>12,996</b>	<b>64,260</b>
Net periodic benefit costs other than service cost	16	7	23	–	23	(39)	(16)
<b>Total expenses</b>	<b>\$32,914</b>	<b>\$9,847</b>	<b>\$42,761</b>	<b>\$8,526</b>	<b>\$51,287</b>	<b>\$12,957</b>	<b>\$64,244</b>
Year ended December 31, 2021							
Salaries and wages	\$21,201	\$6,346	\$27,547	\$1,762	\$29,309	\$5,062	\$34,371
Employee benefits	5,117	1,317	6,434	467	6,901	1,466	8,367
Occupancy and equipment expenses	1,094	306	1,400	145	1,545	732	2,277
Depreciation and amortization	476	4	480	51	531	217	748
Information technology fees	1,001	228	1,229	2,527	3,756	438	4,194
Professional fees—other	774	510	1,284	–	1,284	3,220	4,504
Printing and shipping	–	–	–	204	204	–	204
Other operating expenses	707	390	1,097	69	1,166	1,224	2,390
<b>Total operating program and support expenses</b>	<b>30,370</b>	<b>9,101</b>	<b>39,471</b>	<b>5,225</b>	<b>44,696</b>	<b>12,359</b>	<b>57,055</b>
Net periodic benefit costs other than service cost	45	17	62	–	62	(21)	41
<b>Total expenses</b>	<b>\$30,415</b>	<b>\$9,118</b>	<b>\$39,533</b>	<b>\$5,225</b>	<b>\$44,758</b>	<b>\$12,338</b>	<b>\$57,096</b>

<sup>21</sup> See [ASU 2016-14](#).



Similarly, in [CFA Institute’s FY2022 Annual Report](#), we reconciled our income statement expenses by nature and activity in the notes to the financial statements. Again, this is more granular and decision-useful than what the Proposed Update would require of public business entities.

**CFA Institute**  
**Notes to Consolidated Financial Statements**  
**31 August 2022 and 2021**

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**14. Functional expenses**

Expenses by functional classification for the years ended 31 August 2022 and 2021 consisted of the following (in thousands):

	Program Services				Supporting Services		FY 2022 Total
	Credentialing	Member Value	Industry Engagement	Scholarships - 11 September Memorial Fund	Management and General		
Salaries, Wages and Benefits	\$ 20,402	\$ 33,649	\$ 12,503	\$ —	\$ 38,763	\$ 105,317	
Cost of Sales	5,572	—	145	—	—	5,717	
Professional and Contract Services	56,066	17,916	4,319	—	25,309	103,610	
Facility and Equipment	1,129	2,001	517	—	3,361	7,008	
Travel Expenses	559	393	68	—	674	1,694	
Grants and Sponsorships	1	16,983	380	58	211	17,633	
Advertising	—	4,508	14	—	8,395	12,917	
Bank Charges and Merchant Fees	7,322	2,212	9	—	298	9,841	
Postage, Printing and Supplies	167	842	68	—	237	1,314	
Utilities	305	550	162	—	1,065	2,082	
Depreciation and Amortization	4,449	2,319	369	—	3,083	10,220	
Insurance, Taxes, Interest, and Other	643	859	304	—	4,466	6,272	
<b>Total</b>	<b>\$ 96,615</b>	<b>\$ 82,232</b>	<b>\$ 18,858</b>	<b>\$ 58</b>	<b>\$ 85,862</b>	<b>\$ 283,625</b>	

We are not aware of any great hardship born by the not-for-profit sector after the Board required the disaggregation of expenses by nature and by program and reconciliation with the income statement in 2016.

While it is true that most not-for-profit entities are service operations – while business entities operate with a wide range of business models – we believe that business entities have even more sophisticated information technology and finance teams capable of meeting the same requirements as not-for-profits. Indeed, public company management teams often make qualitative commentary and voluntary disclosures which suggest that they have access to information far beyond what is suggested here.

**Recommendation:** Align the presentation of segment expenses with income statement expenses and require the disaggregation and reconciliation of both by their nature. The template for this lies in the disaggregation requirements for not-for-profit entities in ASC 958-205-45-6. FASB’s recent decision to disaggregate “significant expenses” by segment will only create confusion because of an inability to reconcile disclosure between the overall income statement and segment disclosures.

### **“Achievable Standard Setting”**

We are concerned that numerous compromises were made in the Proposed Update to reduce implementation costs or to complete the project quickly under the new philosophy of “achievable standard setting” that imperil its decision-usefulness for investors.<sup>22</sup>

The philosophy of “achievable standard setting” seems to define successful standard setting as making compromises well before an Exposure Draft is issued to minimize opposition and issue a final standard expeditiously. Such an approach inappropriately subordinates investor protection to other concerns that are irrelevant to, and potentially at odds with, the statutory criteria for what the FASB must consider in standard setting under the Sarbanes-Oxley Act of 2002 (“SOX Act”).

Under the SOX Act, the Securities and Exchange Commission:

*...may recognize as ‘generally accepted’ for purposes of the federal securities laws accounting principles established by a standard setting body that:*

- *is organized as a private entity;*
- *has, for administrative and operational purposes, a board of trustees serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the 2-year period preceding such service, associated persons of any registered public accounting firm;*
- *is funded as provided in Section 109 of the Sarbanes-Oxley Act;*
- *has adopted **procedures to ensure prompt consideration**, by majority vote of its members, **of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices**; and*
- ***considers, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.***

Three important changes in the business environment in the last 50 years are:

1. the increasing size and complexity of multinational companies and the transactions they engage in;
2. the information technology revolution dramatically reducing the cost of producing, distributing, and consuming information; and
3. the institutionalization of capital markets – at least 80% of the public equity market capitalization in the US is owned by institutional investors<sup>23</sup> – resulting in a great increase in the sophistication of financial statement users.

**Recommendation:** After investors have waited so many years, we urge the FASB to abandon the notion of “achievable standard setting” and take the time it needs to craft a standard that truly delivers for investors and meets the FASB’s objectives as outlined in the SOX Act.

<sup>22</sup> Proposed Update, Paragraph BC40, notes: “*The Board determined that the disaggregation of expenses into a predefined and finite number of natural expense categories would achieve a better balance of costs and benefits than the full disaggregation of expenses by nature. That approach also represents more achievable standard setting that can provide investors with tangible benefits on an accelerated timeline when compared with a more protracted approach.*” (emphasis added).

<sup>23</sup> Pensions & Investments (2017), *80% of Equity Market Cap Held by Institutions*, [80% of equity market cap held by institutions | Pensions & Investments \(pionline.com\)](https://www.pionline.com/80-of-equity-market-cap-held-by-institutions)

### ***Cost-Benefit Analysis in Need of Modernization: Has Technology Been Considered?***

We are sensitive to the costs of financial reporting, as they are ultimately born by investors. That said, we struggle to evaluate the costliness arguments advanced by preparers and embraced by the FASB. There are no quantitative cost estimates, surveys of commercial accounting software providers, estimates of implementation costs for analogous standards, nor other evidence provided.

Not-for-profit entities have been held to more robust disaggregation requirements than those in the Proposed Update since 2016 without experiencing any great hardship, and those entities do not have nearly the same amount of investor capital at risk.

Costliness arguments and the acceptance of them by the FASB are virtually unchanged since the 1970s<sup>24</sup>, implying that the cost of preparing and reporting information has been unaffected by the personal computer, enterprise resource planning software, and the internet. Popular accounting software vendors tout their products' capability to drill down from financial statements to individual transaction data<sup>25,26</sup>, and we have heard much about the "digital transformations" that companies and their finance functions have undergone.<sup>27</sup> We have also heard auditors tout the use of technology and artificial intelligence as part of the audit, which presumes a certain sophistication in "client"/"preparer" financial reporting systems. Have any of these advances changed the calculus in the FASB's cost-benefit analysis?

Finally, investors bear significant costs making estimates and assumptions for numbers that are known to management (as suggested by management commentary in, for example, earnings calls) and relatively easy to produce and disclose.

***Recommendation:*** Conduct a survey of leading accounting software providers' capabilities in producing the information needed to disaggregate the financial statements. Conduct a post-implementation review of the amendments to ASC Topic 958 (Not-for-Profit Entities) issued in 2016 ([ASU 2016-14](#)) to see how many additional hours and external resources were needed by not-for-profit entities to comply with the requirements to disaggregate income statement expenses by nature, which were also disaggregated by program/supporting activity.

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<sup>24</sup> Financial Accounting Standards Board. (1976), Statement of Financial Accounting Standards No. 14: *Financial Reporting for Segments of a Business Enterprise*, Paragraph 68 note: "Some respondents contended that the costs of compiling and processing the type of information called for by this Statement would be overly burdensome to many enterprises, particularly those that are relatively small or whose securities are not publicly traded."

<sup>25</sup> See SAP's Accounting, Financial Close, and Reporting Software: "Unified entity and group close reporting: Access a single source of truth for local operational and group-level data, and drill down from consolidated reports to transactional data." [Accounting, Financial Close, and Reporting Software | SAP](#)

<sup>26</sup> See Oracle NetSuite Financial Management Solutions: "Our cloud-based platform delivers real-time visibility into the financial performance of any business, from a consolidated level down to individual transactions." [NetSuite Financial Management](#)

<sup>27</sup> See PwC Digital Transformation > Finance Transformation. [Finance transformation \(pwc.com\)](#)

***Investors In Private & Public Business Entities Have Same Information Needs (Question #2)***

The Board's belief that investors in private business entities receive detailed, disaggregated information and enjoy privileged access to management is inaccurate, as expressed by investors at the recent FASAC meeting and elsewhere. Only controlling shareholders would have broad access to information and to management directly with any regularity.

Private business entities are often compared to public business entities by investors and the distinction between them continues to blur, as pension funds and other institutional investors increase allocations to private equity and private credit. Investors in private and public business entities have the same information needs and US GAAP should provide for a minimum level of decision-useful information for noncontrolling investors.

In addition, not-for-profit entities presumably have fewer financial resources and sophistication than many business entities and have greater disaggregation requirements.

<p><b><i>Recommendation:</i></b> Widen the scope of the Proposed Update to include all business entities, public and private.</p>
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### *Insufficient Disaggregation from the Requirements & Qualitative Descriptions of “Other” (Questions #3 and #14)*

Question #3 in the Proposed Update queries whether the proposed disclosure of relevant expense captions disaggregated into the required expense categories would provide decision-useful information for investors and how that information would be used. Question #14 queries whether the proposed qualitative descriptions of “other” in each disaggregated relevant expense caption (i.e., the un-disaggregated amount remaining) would be decision useful.

We believe the proposed disaggregation requirements could provide decision-useful information, as discussed at length earlier in our comments, but would be limited by large balances of “other,” owing to the limitations inherent in specifying only five required expense categories for disaggregation. In the FASB’s own hypothetical example of the manufacturing company with service operations,<sup>28</sup> “other” accounted for 24% and 25% of the company’s cost of services and SG&A expenses, respectively. We expect similarly large balances of “other” in practice, because the list of required expense categories used for disaggregating the relevant expense captions is short and omits several common categories of expenses found in income statement expense captions today.

The proposed qualitative descriptions of “other” would have little decision-usefulness for investors. On the one hand, it is information that management does not provide today (i.e., See Apple example, no description or definition of income statement expense captions are provided). On the other hand, without numbers, the disclosure it is not useful for evaluation or valuation purposes.

The FASB should seek to minimize the balances of “other” by:

- (a) increasing the number of required expense categories;
- (b) removing the requirement that certain expenses must be in a single, not multiple, expense caption to be broken out; and
- (c) imposing a ceiling of 5% for “other” (i.e., floor of 95%) in a disaggregation of each relevant expense caption.

Finally, we note it is challenging to predict how unknown information will be used once it is known. Until investors can see these disclosures for a given company, and how they fit with other disclosures, they cannot be certain how, if at all, their investment decision-making will be impacted.

#### Recommendations:

- (1) Add, for disclosure, the following required expense categories based on the FASB’s definition of “natural expense classification” in ASC Topic 958: professional services, occupancy costs other than depreciation, supplies, third-party software, and utilities.
- (2) Remove the exemption in Paragraph 220-40-50-13 of the Proposed Update for disaggregating certain expense categories if they are in multiple income statement expense captions.
- (3) Require each “other” expense category not to exceed 5% of each disaggregated relevant expense caption. In meeting the 5% ceiling, management discretion can be given for defining and breaking out additional categories beyond those required.

<sup>28</sup> Proposed Update, Paragraphs 250-40-55-4 through 12.

### ***Employee Compensation Definition and Disclosures: Labor Costs Not Clear (Question #6)***

We have no objections to leveraging the definition of “employee” from ASC Topic 718 or to the proposed definition of “employee compensation.” Both have the benefit of close alignment with the definitions for the same terms in IFRS 2, *Share-based Payments* and IAS 19, *Employee Benefits*.

One of the key needs of investors, as described in the Proposed Update, is disclosure and understanding of entities’ labor costs. The Proposed Update disclosure of employee compensation costs may not, however, satisfy that need for several reasons:

- 1) ***Inconsistent Disaggregation of Labor Costs Between Tangible & Intangible Assets*** – Some labor costs are capitalized to inventory and to other assets, like intangibles, before getting recognized as an expense on the income statement. The Proposed Update requires the further disaggregation of “inventory and manufacturing expense,” included in cost of tangible goods sold, into employee compensation and other categories. However, this treatment is not applied to instances of capitalized labor costs within intangible assets that is ultimately expensed to the income statement through amortization expense.

For example, a company that produces streaming video content will incur labor costs for the cast, crew, writers, and others. These costs are capitalized to the balance sheet as a content asset, which are recognized over time on the income statement as amortization expense after content is released to customers. It is our understanding that the Proposed Update would not require this amortization expense to be disaggregated into employee compensation and other natural expense categories that are capitalized into intangible assets – as they are done for inventory in a goods-related business.

Therefore, the sum of “employee compensation” from the tables required in the Proposed Update would understate, potentially significantly, the labor costs for a company that capitalizes labor costs to intangible assets. In essence, the Proposed Update requires further disaggregation for the cost of *tangible* goods sold but not *intangible* costs of sales that are more common in the modern economy.

Based on the Board’s public deliberations thus far on software development costs, it appears that greater capitalization of labor costs to the balance sheet is on the horizon, too. As such, it seems inconsistent to treat the costs to tangible and intangible assets differently.

- 2) ***Labor Costs for Employees & Non-Employees*** – Companies use contract labor and other personnel who are not, under common law or IRS rules, employees. These individuals are outside the scope of the proposed definition of “employee” and payments to them in exchange for services are outside the scope of the proposed definition of “employee compensation.” Non-employee personnel compete in the same labor market as employees and, as such, are similarly affected by wage trends. Omitting the costs of their services would underestimate the labor intensity and labor costs for many companies and privilege form over substance of the arrangements in disclosures to investors.
- 3) ***Disaggregation of Types of Compensation Expense*** – Different forms of compensation – salaries and wages, termination benefits, incentive payments, stock-based payments, non-cash benefits, etc. - behave differently as they have different drivers. In the Proposed

Update, disaggregation of termination benefits is required, but all other forms of compensation are aggregated into a single “employee compensation” line.

- 4) ***Total Human Capital Costs Disclosure Necessary*** – Employee compensation is required to be disaggregated in various expense captions, but it is not required to be aggregated to provide a total employee compensation expense disclosure for the organization. In other words, the disaggregated employee compensation amounts will not be aggregated for an overall entity-wide (i.e., or segment) employee compensation amount.

*Recommendations:*

(1) Require the further disaggregation of amortization expense using costs incurred and capitalized to intangible assets, similar to the further disaggregation of inventory and manufacturing expense that disaggregates costs incurred for inventories. This will prevent labor costs capitalized to intangible assets from escaping disclosure, which can be significant for some companies.

(2) Create definitions for – and require disclosure of – *non-employees who provide similar services to employees*, such as contract workers and non-employee directors, and *payments to non-employees who provide similar services to employees*.

(3) Require the disaggregation of compensation costs by salaries and wages, payments to non-employees who provide similar services, stock-based compensation, incentive payments, and benefits. Different forms of compensation have different drivers that are relevant to evaluation and modeling.

(4) Require a dedicated footnote disclosure for “total costs of human capital” – disaggregated by nature from the various functional income statement captions – like what is required under Paragraph 104 in IAS 1, *Presentation of Financial Statements*, except that the scope should be widened to not only include “employee compensation” but also “payments to non-employees who provide similar services to employees.” This will give investors a clear understanding of a company’s labor intensity and sensitivity to risks such as rising wages.

### ***Integration of Existing Disclosure Requirements (Questions #7, #12, and #13)***

The Proposed Update would require that an entity include certain existing disclosures of expenses in the same tabular format as the newly disaggregated expense disclosures required by the Proposed Update. We support this requirement. Tabular disclosures would improve investors' ability to locate relevant expense information in the notes to financial statements and contextualize them within the expense captions presented on the income statement.

We support integrating disclosures of stock-based compensation, the effects of changes in exchange rates, and all other required and voluntary quantitative disclosures related to income statement expense captions into the new tabular disaggregation of expenses.

To improve the presentation of the expense disaggregation and ensure investors of its completeness, we recommend that the disaggregation tables in the Proposed Update also provide a total of each type of expense disaggregated by nature from multiple functional line items to provide the total expense for the entity by nature. We highlight this above for "employee compensation", but it should be applicable for other expenses disaggregation by nature appearing in multiple income statement captions.

#### **Recommendations:**

(1) Integrate stock-based compensation, effects of changes in exchange rates, and all other required and voluntary quantitative disclosures related to income statement expense captions into the newly required tabular disaggregation of expenses.

(2) Require that disaggregation tables to be provided under the Proposed Update also provide a total for each type of expense which has been disaggregated by nature from multiple functional income statement captions. That is, require disclosure of the total amount of each expense category (e.g., employee compensation expense) and its allocation across the income statement expense captions.



### ***Further Disaggregation of Inventory and Manufacturing Expense (Question #8)***

Today, costs of sales are often a highly aggregated quantity of unknown composition that is difficult to evaluate and forecast. For many companies, it is the largest expense caption on the income statement, so its disaggregation is essential.

#### ***“Costs Incurred” Approach Will Cause Confusion in the Absence of Context***

The proposed amendments would require disaggregation of cost of sales into the required expense categories, plus further disaggregation of *inventory and manufacturing expense* into (a) purchases of inventory, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) DD&A. This further disaggregation is done using “costs incurred”, or costs that “flow in” to the balance sheet as inventory, plus manufacturing costs that are expensed directly. The sum of the costs incurred, or flowing into inventory, would be reconciled to total *inventory and manufacturing expenses* using changes in inventories (from the balance sheet) and, essentially, a plug figure titled “other reconciling items and adjustments.” The “changes in inventory” is simply meant to offset the “costs incurred” (“flow in”) which are presented in a disaggregated fashion and the plug figure titled “other reconciling items and adjustments” is meant to remove items occurring in the balance sheet change in inventory which do not impact the income statement in cost of sales. What investors need is what comes out of inventory to the income statement.

While we recognize the nature of certain costs may be lost when they are capitalized to the balance sheet, this proposed “costs incurred” (“flow in”) approach will likely cause confusion because it is presented as a means of explaining an income statement expense (costs of sales), but it represents costs capitalized to inventory rather than costs flowing out to cost of sales. Without investors reading the detailed provisions of this Proposed Update, it is unlikely that investors will even be able to understand what this approach is meant to convey.

Companies with low inventory turnover or that experience a change in customer demand, supply chain issues, inventory obsolescence, inflation, and so on, will likely report large “changes in inventory” figures. In the absence of further disaggregation and explanation, “changes in inventory” and the corresponding “other reconciling items and adjustments” have no decision-usefulness for investors because they can result from several factors with different implications, such as unanticipated changes in customer demand, advance inventory purchases, obsolete inventory, impairments, acquisitions and disposals, and FX translations.

We believe confusion can be partially mitigated by requiring the disclosure of an inventory rollforward that places capitalized and expensed inventory costs in their proper context with the inventory account on the balance sheet, such as:

Beginning inventory

Plus: Inventory costs capitalized

(disaggregated as part of inventory and manufacturing costs incurred)

Minus: Inventory costs expensed to the income statement

(recognized as part of costs of goods sold)

Plus/Minus: Other changes such as write-downs and changes in FX (disaggregated)

Ending inventory

With this rollforward investors will have been sent of cohesiveness of the changes in the balance sheet account relative to the income statement.

### ***“Purchases of Inventory” Will Be Unclear for Manufacturers***

For retailers and distributors, the “purchases of inventory” cost incurred category for disaggregating inventory and manufacturing expense is clear because they purchase, generally, finished goods. For manufacturers, “purchases of inventory” is less clear as we believe it would aggregate purchases of raw materials, intermediate goods, and supplies that each have different economic drivers. We recommend replacing “purchases of inventory” with “purchases of raw materials” and “purchases of intermediate and finished goods” categories to better fit a range of business models.

### ***Expanding Disaggregation to Costs of Sales Beyond Just Tangible Goods***

As we discussed in our response to Question #6 using the example of a company producing streaming content, some labor costs are capitalized within other assets, like intangibles, before getting recognized as an expense on the income statement. While the Proposed Update requires the further disaggregation of “inventory and manufacturing expense,” of tangible goods sold, further disaggregation will not be required in cases of intangibles like services.

We recommend that further disaggregation should be applied to amortization expense, for each of the income statement captions that contain amortization expense. This way, capitalization will not obscure the underlying nature of costs.

#### **Recommendations:**

- (1) Require an inventory rollforward disclosure that reconciles inventory on the balance sheet, costs of goods sold on the income statement, and the disaggregation of costs of goods sold. Captions on the rollforward should match the captions that appear in the disaggregation table. This will alleviate confusion related to the proposed, complex disaggregation of inventory and manufacturing expense.
- (2) Require disaggregation and description of “changes in inventory” & “other reconciling items and adjustments” within the further disaggregation of inventory and manufacturing expenses. Without explanation and disaggregation these captions will create confusion.
- (3) Replace the “purchases of inventory” expense category (used in further disaggregation of inventory and manufacturing expense) with “purchases of raw materials” and “purchases of intermediate and finished goods” to better accommodate manufacturing activities.
- (4) As already stated, require the further disaggregation of amortization expense using costs incurred and capitalized to intangible assets, similar to the further disaggregation of inventory and manufacturing expense that disaggregates costs incurred for inventories. This will prevent labor costs capitalized to intangible assets from escaping disclosure, which can be significant for some companies.

### ***Definition and Disclosure of Selling Expenses (Question#15)***

We strongly support the proposed disclosure of selling expenses. We do, however, have reservations about the Board leaving the definition of selling expenses to management, which risks an unacceptably wide range of definitions that impairs comparability across issuers and even for the same issuer over time. We prefer a definition created by the Board that incorporates some but not full discretion by management. We also urge the Board to require the disclosure of selling expenses to include its location on the income statement.

#### ***Recommendations:***

(1) Define selling expenses. The FASB introduces the term “selling expenses” but leaves it up to management to define. An objective of disaggregation is improving investors’ understanding of the nature and behavior of expenses. Introducing a new expense term without defining it and not providing for its disaggregation or its location on the income statement contravenes that objective.

(2) Require the disclosure of selling expenses to include its location on the income statement. If it is included in multiple expense captions, that allocation must be disclosed.

### ***Interim Reporting (Question #16)***

We strongly support the proposed requirements for disclosures on an interim basis. Investing is continuous, companies report the aggregated results on an interim basis, and interim reporting is vital for confirmatory and predictive value.

### ***Transition and Effective Date (Questions #17 and #19)***

We always support retrospective adoption and the earliest possible adoption of new accounting standards so that investors can benefit from decision-useful information as soon as possible. Retrospective adoption is vital for comparative and trend information. If this standard is adopted prospectively, it will take years for investors to obtain enough information to identify trends and make inferences.

At a minimum, we recommend adoption of the standard for the current period and comparative periods presented on quarterly and annual reports after the effective date. For example, if the final standard is effective for calendar year 2025, disaggregated income statement expenses would be presented in the 2025 annual report for 2025, 2024, and 2023 – the current and comparative periods presented on the income statement. Similarly, the first quarterly report (1Q25) should include disaggregated income statement expenses for the current and comparative periods presented: 1Q25 and 1Q24.

***Recommendation:*** Require retrospective adoption for comparative interim and annual periods after the effective date.

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Thank you for your consideration of our views and perspectives. We would welcome the opportunity to meet with you to provide more detail on our letter. If you have any questions or seek further elaboration of our views, please contact Sandra J. Peters at [sandra.peters@cfainstitute.org](mailto:sandra.peters@cfainstitute.org) and Matthew P. Winters at [matt.winters@cfainstitute.org](mailto:matt.winters@cfainstitute.org).

Sincerely,

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