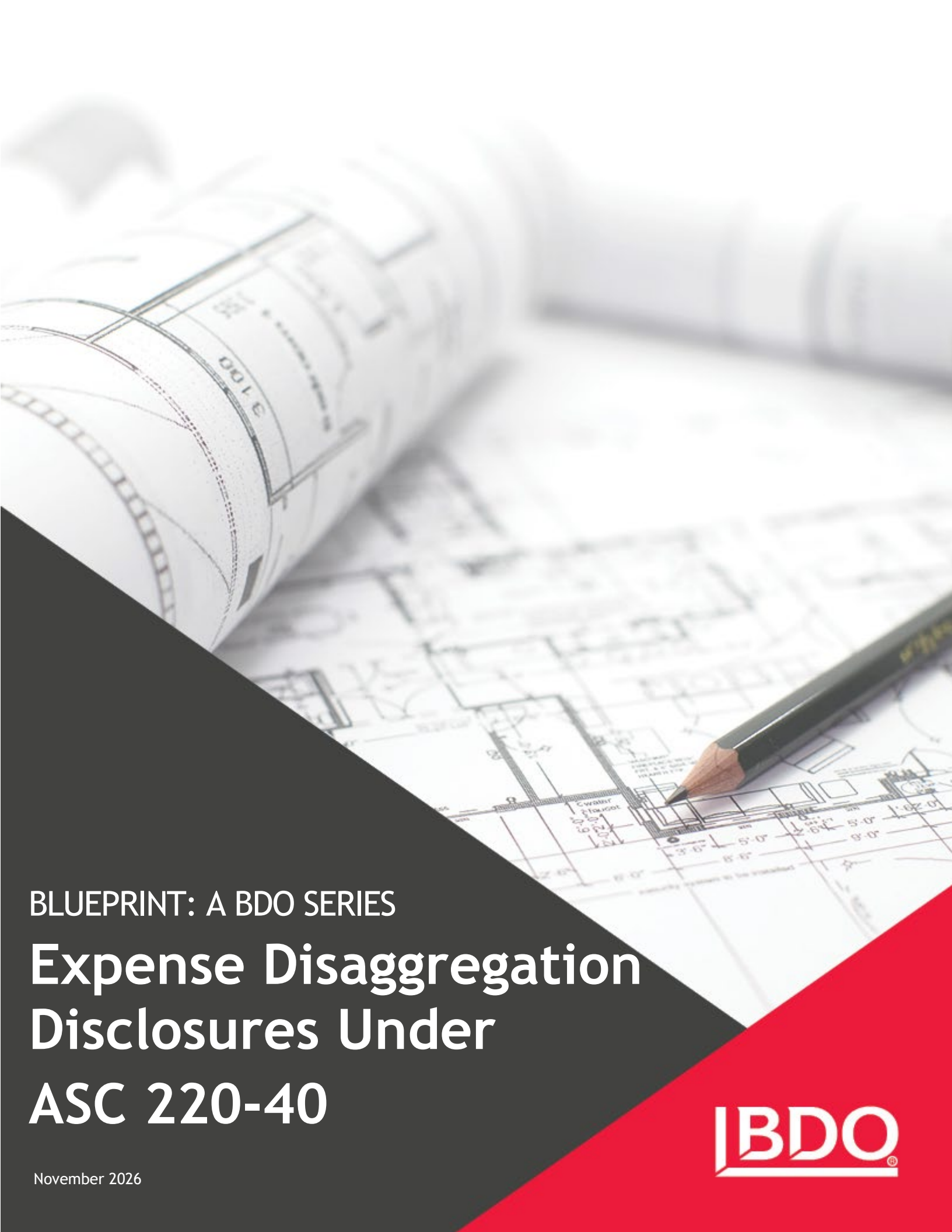


BLUEPRINT: A BDO SERIES

Expense Disaggregation Disclosures Under ASC 220-40

November 2026

TABLE OF CONTENTS

Introduction 2
ASC 220-40 in a Nutshell 2
Objectives and Scope 2
Expense Disaggregation and Other Required Disclosures 3
Illustrative Examples 4
Effective Date and Transition 4
About the Blueprint 4
Acknowledgments 5
Chapter 1: Objectives and Scope 6
1.1 Overview and Objectives of ASC 220-40 6
1.2 Scope 7
Chapter 2: Expense Disaggregation and Other Required Disclosures 9
2.1 Overview: Expense Disaggregation and Other Required Disclosures 9
2.2 Identifying Relevant Expense Captions 11
2.3 Required Expense Categories 12
2.4 Expenses Exempt From Disaggregation 26
2.5 Integration of Existing Disclosure Requirements 29
2.6 Expense Reimbursement and Cost Sharing Arrangements 34
2.7 Other Items Remaining in Relevant Expense Captions 35
2.8 Selling Expenses 35
2.9 Presentation Changes 36
Chapter 3: Illustrative Examples 37
3.1 Overview 37
3.2 Illustrative Examples 37
Chapter 4: Effective Date and Transition 47
4.1 Overview 47
4.2 Effective Date 47
4.3 Transition Approaches 48
Appendix A: Other BDO Publications 49
Contacts 50

Introduction

In response to stakeholder requests for more information about expenses, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2024-03: *Income Statement — Reporting Comprehensive Income — Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*. The effective dates of ASU 2024-03 were later clarified by ASU 2025-01, *Income Statement — Reporting Comprehensive Income — Expense Disaggregation Disclosures (Subtopic 220-40): Clarifying the Effective Date*. These ASUs were codified in Accounting Standards Codification (ASC) 220-40.

This Blueprint explains how a public business entity (PBE) applies the requirements in ASC 220-40 to identify relevant income statement expense captions and disclose information about required expense categories. It also provides graphics and examples to help readers understand the disclosure guidance. The graphics and examples in this Blueprint are intended to be illustrative only; individual PBEs' disclosures may vary based on the facts and circumstances and therefore may differ from the illustrations provided in this Blueprint.

ASC 220-40 IN A NUTSHELL

For each relevant expense caption, ASC 220-40 requires PBEs to provide expense disaggregation disclosures in both interim and annual reporting periods. Specifically, ASC 220-40 requires PBEs to disaggregate relevant expense captions into the following natural expense categories:

- Purchases of inventory
- Employee compensation
- Depreciation
- Intangible asset amortization
- Depreciation, depletion, and amortization (DD&A)

ASC 220-40 also requires PBEs to separately disclose selling expenses and integrate specific disclosures required by other U.S. GAAP.

OBJECTIVES AND SCOPE

The objective of ASC 220-40 is to provide transparency about the components of specific expense captions in the income statement. ASC 220-40 applies to PBEs as defined in the ASC Master Glossary. ASC 220-40 does not apply to private companies, not-for-profit entities, or employee benefit plans.

For more information on the objectives and scope of ASC 220-40, see Chapter 1.

EXPENSE DISAGGREGATION AND OTHER REQUIRED DISCLOSURES

ASC 220-40 requires PBEs to provide the following disclosures in both interim and annual reporting periods:

DISCLOSURE	REQUIREMENTS (FOR INTERIM AND ANNUAL REPORTING PERIODS)
Expanded expense disclosures	▶ Identify **relevant expense captions** presented on the face of the income statement in continuing operations. ▶ Disaggregate each relevant expense caption into the following **required expense categories** in a tabular format in the notes to the financial statements: • Purchases of inventory • Employee compensation • Depreciation • Intangible asset amortization • DD&A recognized as part of oil and gas-producing and other extractive activities ▶ Disclose expenses exempt from disaggregation in **other items** or elsewhere.
Disclosures required by other U.S. GAAP	▶ Include disclosures of specific expenses, gains, and losses required by other U.S. GAAP, as applicable, for each relevant expense caption. ▶ Present the amount required by other U.S. GAAP in the table as a separate line item.
Expense reimbursements and cost sharing arrangements	▶ Disclose **expense reimbursements** related to cost sharing or expense reimbursement arrangements with another entity, as applicable, for each relevant expense caption. • Present reimbursements to another entity as a separate line item in the table. • Present reimbursements from another entity either as a separate line item in the table or on a net basis within the relevant expense category, with a separate disclosure of the policy applied.
Other items remaining in relevant expense captions	▶ Include an amount for **other items**, which represents the difference between the total relevant expense caption and the aggregate of all separately disclosed expense categories. ▶ Describe qualitatively what is included in other items.
Selling expenses	▶ Disclose how the entity defines **selling expenses**. (This requirement only applies annually, unless the definition changes in an interim period.) ▶ Disclose the total selling expenses recognized in continuing operations in the notes to the financial statements.
Changes in presentation	▶ Disclose any changes in definition or election that result in disclosure **presentation changes**. ▶ Recast prior periods to conform with changes in definition or election (unless impracticable).

For more information on expense disaggregation and other required disclosures, see Chapter 2.

ILLUSTRATIVE EXAMPLES

ASC 220-40 includes three examples to illustrate the disaggregation of relevant expense captions which are reproduced in this Blueprint.

For more information, see Chapter 3.

EFFECTIVE DATE AND TRANSITION

ASC 220-40 is effective for annual reporting periods beginning after December 15, 2026, and for interim reporting periods within annual reporting periods beginning after December 15, 2027. In other words, a calendar-year PBE must apply ASC 220-40 to annual reports beginning January 1, 2027 for the year ended December 31, 2027, and to interim reports thereafter (beginning the quarter ending March 31, 2028). Early adoption is permitted.

For more information on the effective date and transition, see Chapter 4.

ABOUT THE BLUEPRINT

This Blueprint summarizes ASC 220-40, incorporating the guidance in the following ASUs:

- ASU 2024-03, *Income Statement — Reporting Comprehensive Income — Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*
- ASU 2025-01, *Income Statement—Reporting Comprehensive Income — Expense Disaggregation Disclosures (Subtopic 220-40): Clarifying the Effective Date*
- ASU 2025-10, *Government Grants (Topic 832): Accounting for Government Grants Received by Business Entities*
- ASU 2026-02, *Environmental Credits and Environmental Credit Obligations (Topic 818)*

It also includes practical examples and interpretive guidance to help companies and practitioners apply ASC 220-40.

This Blueprint is divided into chapters that are organized in the same order that a PBE applies the guidance in ASC 220-40. Chapter 1 discusses the objectives and scope of ASC 220-40. Chapter 2 explains the disclosure requirements and describes the process by which a PBE applies those requirements. Chapter 3 provides illustrative examples. Finally, Chapter 4 discusses the effective dates and transition related to ASC 220-40.

The following illustration depicts the organization of this Blueprint:



ACKNOWLEDGMENTS

This Blueprint, published by BDO's Professional Practice, is the culmination of efforts of many individuals, to whom we express our sincere appreciation.

- Jennifer Kimmel
- Adam Brown
- Angela Newell
- Meghan Depp
- Paula Hamric
- Iliyana Dale
- Bobbi Gwinn
- Bharath Karnati
- Meredith Taylor
- Lisa Edelman
- Elizabeth Robinson

Chapter 1: Objectives and Scope



1.1 OVERVIEW AND OBJECTIVES OF ASC 220-40

The FASB introduced ASC 220-40 in response to investor demand for greater transparency and more decision-useful information about a PBE's cost structure. In developing ASC 220-40, the FASB sought to balance the benefits of enhanced transparency with the operational costs to preparers. It concluded that the best course of action was to require PBEs to disaggregate relevant expense captions into a finite and standardized set of expense categories in a tabular format, reasoning that doing so would provide meaningful insight while remaining practical to implement. This targeted approach was intended to improve consistency and comparability across entities, enabling investors to better analyze expense trends, evaluate performance over time, and develop more informed expectations about future cash flows.

The objective of ASC 220-40 is to provide detailed information about the composition of relevant expense captions in the income statement and the relative proportion and trends of each expense category within those captions. A relevant expense caption is an expense caption presented on the face of the income statement within continuing operations that contains at least one required expense category (see below). ASC 220-40 requires PBEs to disaggregate relevant expense captions into the following natural expense categories:

- Purchases of inventory
- Employee compensation
- Depreciation
- Intangible asset amortization
- DD&A recognized as part of oil and gas-producing and other extractive activities

ASC 220-40 also requires PBEs to separately disclose selling expenses and integrate specific disclosures required by other U.S. GAAP.

Before ASC 220-40, U.S. GAAP did not contain broad requirements to disaggregate income statement expense captions into natural expense categories. However, other U.S. GAAP required separate disclosure of specific expenses, gains, and losses. Under ASC 220-40, such disclosures must be integrated into the new tabular disclosure.

1.2 SCOPE

FASB REFERENCES

ASC 220-40-15-1 through 15-3

ASC 220-40-20: Public Business Entity

> *A public business entity is a business entity meeting any one of the criteria below. Neither a not-for-profit entity nor an employee benefit plan is a business entity.*
>
> > *a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).*
> >
> > *b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.*
> >
> > *c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.*
> >
> > *d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.*
> >
> > *e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including notes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.*
>
> *An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.*

ASC 220-40 applies to PBEs as defined in the ASC Master Glossary. ASC 220-40 does not apply to employee benefit plans within the scope of ASC 960, *Plan Accounting — Defined Benefit Pension Plans,* ASC 962, *Plan Accounting — Defined Contribution Pension Plans*, or ASC 965, *Plan Accounting — Health and Welfare Benefit Plans,* private companies, or not-for-profit entities.

PUBLIC BUSINESS ENTITY DEFINITION

Although ASC 220-40 generally does not apply to private companies, some private companies may meet the PBE definition. Entities should assess whether they currently meet, or may subsequently meet, the PBE definition, as it extends beyond entities with securities listed on a national securities exchange. The definition includes:

- Entities whose securities are listed on or traded in an over-the-counter (OTC) market, regardless of trading volume or whether they issue publicly available financial statements.

- Entities that file or furnish financial statements with the SEC, such as:
    - Significant acquired or to-be-acquired businesses or real estate operations whose financial statements are filed under Rule 3-05 or Rule 3-14 of Regulation S-X
    - Significant equity method investees whose financial statements are filed under Rule 3-09 of Regulation S-X
    - Broker-dealers
    - Voluntary filers

If a private company is contemplating going public through an initial public offering, a merger with a public company (including a special purpose acquisition company), or another transaction that might cause it to meet the PBE definition, it should prepare in advance to meet the requirements of ASC 220-40.

BDO INSIGHT 1-1: PRIVATE COMPANIES MAY BE REQUIRED TO PROVIDE DISAGGREGATED EXPENSE DISCLOSURES IN THE FUTURE

At a December 2024 meeting, Private Company Council (PCC) members discussed whether it would be beneficial for private companies to adopt income statement expense disaggregation requirements similar to those of ASC 220-40. Although PCC members acknowledged that more detailed expense information could improve credit, lending, and investment analyses, especially in situations where users' direct access to management is limited, the PCC ultimately adopted a "wait-and-see" approach, preferring to evaluate the cost, operability, and usefulness of public company implementation before extending similar requirements to private companies.

Private companies should monitor future PCC meetings for updates regarding the potential expansion of income statement disclosure requirements.

Chapter 2: Expense Disaggregation and Other Required Disclosures



2.1 OVERVIEW: EXPENSE DISAGGREGATION AND OTHER REQUIRED DISCLOSURES

ASC 220-40 requires PBEs to provide expanded disclosures about relevant expense captions in both interim and annual reporting periods, as summarized below:

DISCLOSURE	REQUIREMENTS (FOR INTERIM AND ANNUAL REPORTING PERIODS)
Expanded expense disclosures (Sections 2.2 through 2.4)	▶ Identify **relevant expense captions** presented on the face of the income statement in continuing operations (see Section 2.2). ▶ Disaggregate each relevant expense caption into the following **required expense categories** in a tabular format in the notes to the financial statements (see Section 2.3): • Purchases of inventory (see Section 2.3.2) • Employee compensation (see Section 2.3.3) • Depreciation (see Section 2.3.4) • Intangible asset amortization (see Section 2.3.4) • DD&A recognized as part of oil and gas-producing and other extractive activities (see Section 2.3.5) ▶ Disclose expenses exempt from disaggregation in **other items** or elsewhere (see Section 2.4).

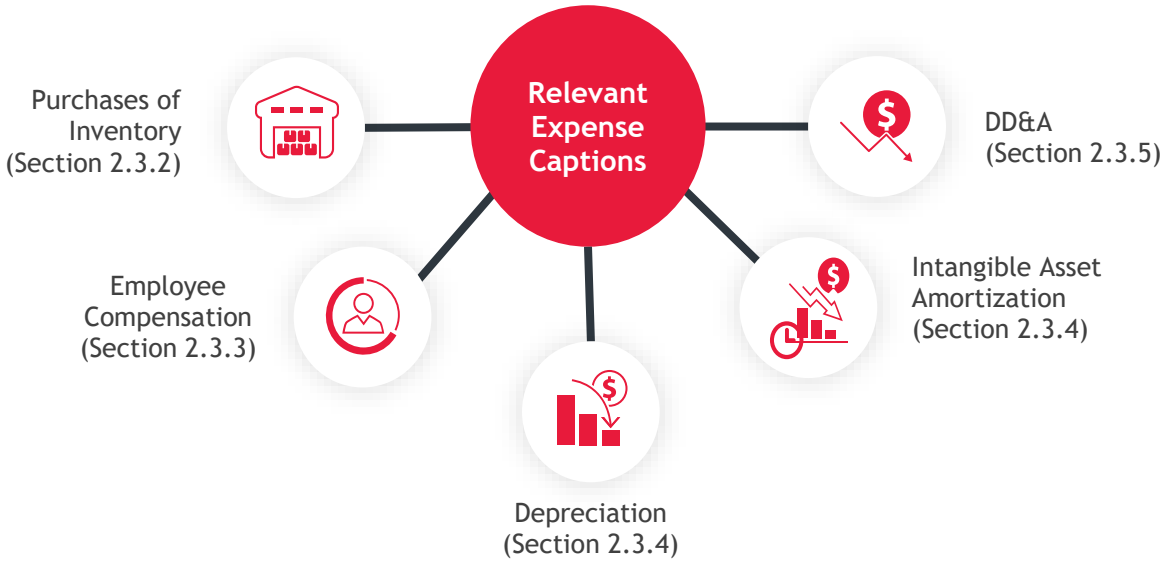
DISCLOSURE	REQUIREMENTS (FOR INTERIM AND ANNUAL REPORTING PERIODS)
Disclosures required by other U.S. GAAP (Section 2.5)	▶ Include disclosures of specific expenses, gains, and losses required by other U.S. GAAP, as applicable, for each relevant expense caption. ▶ Present the amount required by other U.S. GAAP in the table as a separate line item.
Expense reimbursements and cost sharing arrangements (Section 2.6)	▶ Disclose **expense reimbursements** related to cost sharing or expense reimbursement arrangements with another entity, as applicable, for each relevant expense caption. • Present reimbursements to another entity as a separate line item in the table. • Present reimbursements from another entity either as a separate line item in the table or on a net basis within the relevant expense category, with a separate disclosure of the policy applied.
Other items remaining in relevant expense captions (Section 2.7)	▶ Include an amount for **other items**, which represents the difference between the total relevant expense caption and the aggregate of all separately disclosed expense categories. ▶ Describe qualitatively what is included in other items.
Selling expenses (Section 2.8)	▶ Disclose how the entity defines **selling expenses**. (This requirement only applies annually, unless the definition changes in an interim period.) ▶ Disclose the total selling expenses recognized in continuing operations in the notes to the financial statements.
Changes in presentation (Section 2.9)	▶ Disclose any changes in definition or election that result in disclosure **presentation changes**. ▶ Recast prior periods to conform with changes in definition or election (unless impracticable).

2.2 IDENTIFYING RELEVANT EXPENSE CAPTIONS

FASB REFERENCES

ASC 220-40-50-5 through 50-6, ASC 220-40-50-10, and ASC 220-40-50-12

To present expanded expense disclosures in a tabular format, an entity must first identify **relevant expense captions** to disaggregate. A relevant expense caption is one that is presented on the face of the income statement in continuing operations **and** includes one or more of the expense categories specified by ASC 220-40 (see the graphic below):



For some entities, the identified relevant expense captions could differ between interim and annual periods. The reason such differences may occur is that some entities provide condensed statements for interim reporting periods, which contain different expense captions than the statements presented in annual reporting periods.

The elements of the required tabular disaggregation depend on the composition of the relevant expense caption (see the table below).

COMPOSITION OF RELEVANT EXPENSE CAPTION	REQUIRED DISAGGREGATION
Consists entirely of a single expense category	A relevant expense caption that consists entirely of a single expense category does not require further disaggregation. For example, if an income statement line item labeled “depreciation” consists entirely of depreciation, the income statement presentation satisfies the disclosure requirements in ASC 220-40, and no additional disclosure is required.
Includes more than one expense category	A relevant expense caption that includes more than one expense category requires disaggregation, including when the caption is presented using a natural expense classification. For example, an income statement line item labeled “depreciation and amortization” that includes both depreciation and intangible asset amortization requires disaggregation into the two required expense categories (see Section 2.3).

COMPOSITION OF RELEVANT EXPENSE CAPTION	REQUIRED DISAGGREGATION
Includes amounts in the scope of ASC 330, *Inventory*	A relevant expense caption that includes inventory-related amounts within the scope of ASC 330 must be disaggregated by consistently applying either the cost-incurred approach or the expense-incurred approach across the relevant expense categories that comprise the caption (see Section 2.3.2).
Includes a subset of a required expense category	An expense caption that includes a subset of a required expense category qualifies as a relevant expense caption and, accordingly, requires disaggregation. For example, amortization of a right-of-use asset for a finance lease and amortization of leasehold improvements represent subsets of either depreciation or intangible asset amortization; the presence of either expense causes an income statement expense caption to qualify as a relevant expense caption and, accordingly, requires further disaggregation (see Section 2.3.4).

BDO INSIGHT 2-1: SG&A, R&D, AND SIMILAR CAPTIONS TYPICALLY QUALIFY AS RELEVANT EXPENSE CAPTIONS

Although ASC 220-40 does not specify them by name, specific common expense captions typically qualify as relevant expense captions. These include expense captions prescribed by the SEC (under Rule 5-03 of Regulation S-X), as well as other commonly used expense captions. For example, selling, general and administrative expenses (SG&A), and research and development (R&D) are likely to qualify as relevant expense captions. Cost of sales, cost of goods sold, and cost of services are also likely to qualify. Nevertheless, determining whether an expense caption is subject to disaggregation is based on the substance of the expenses included within the caption, rather than the title of the caption.

For example, SEC registrants and other PBEs required to comply with Rule 5-03 of Regulation S-X must present cost of sales and SG&A on the face of the income statement. Some entities also present other captions (for example, R&D expenses) containing specific types of expenses, such as employee compensation, that are relevant to investors. As a result, captions such as cost of sales, SG&A, and R&D expenses, which typically include at least one of the required expense categories, are usually identified as relevant expense captions, even though ASC 220-40 does not specify them by name.

2.3 REQUIRED EXPENSE CATEGORIES



FASB REFERENCES

ASC 105-10-05-6, ASC 220-40-50-1 through 50-3, ASC 220-40-50-5 through 50-6, and ASC 220-40-55-2

ASC 220-40 requires PBEs to disaggregate all relevant expense captions identified in Section 2.2 into specified expense categories and disclose them in a tabular format in the notes to the financial statements. The tabular disclosure is required for both interim and annual reporting periods.

EXPENSE DISAGGREGATION DISCLOSURES UNDER ASC 220-40

The required expense categories and related concepts are addressed in the following applicable Blueprint sections:

DESCRIPTION	REFERENCE
Natural Versus Functional Expenses	Section 2.3.1
Purchases of Inventory	Section 2.3.2
Employee Compensation	Section 2.3.3
Depreciation and Intangible Asset Amortization	Section 2.3.4
DD&A	Section 2.3.5

ASC 220-40 allows an entity to use estimates or other methods that produce a reasonable approximation of the amounts required to be disclosed.

BDO INSIGHT 2-2: USE OF ESTIMATES

The FASB acknowledged broad stakeholder concerns about potential reporting system and process limitations in preparing the disaggregated disclosures using transaction-level detail. As a result, the Board clarified that an entity can use estimates or other methods that produce a reasonable approximation of the required disclosure amounts.

In accordance with this guidance, we believe an entity can use transaction-level detail, estimates, or a combination of those approaches to compute disclosure amounts. When applying estimates, an entity should:

- Consider all reasonably available information including current data, historical trends, forecasts, and allocations
- Document its estimation approach, assumptions, and relevant internal controls
- Regularly compare estimates to actual outcomes and re-evaluate the estimation methodology as appropriate

Estimating amounts in accordance with the disclosure requirements requires the application of professional judgment based on the facts and circumstances.

BDO INSIGHT 2-3: FLEXIBILITY IN PRESENTATION OF TABULAR DISCLOSURES

ASC 220-40 requires an entity to present disaggregated expense information in a tabular format; however, the guidance is industry-agnostic, and it does not prescribe a specific format for that table. Therefore, the structure and presentation of the tabular disclosure may vary across entities depending on the nature of their operations and financial reporting practices. Entities may structure the tabular disclosure in a manner that reflects their facts and circumstances, provided that all required expense categories are clearly presented.

Determining how to format the tabular disaggregation requires the application of professional judgment based on the facts and circumstances.

DISAGGREGATION REQUIREMENTS DO NOT APPLY TO IMMATERIAL ITEMS

ASC 105, *Generally Accepted Accounting Principles*, states that "*the provisions of the Codification*" (including the disaggregation requirements under ASC 220-40) "*need not be applied to immaterial items*." Accordingly, the requirements to disaggregate relevant expense captions into required expense categories and provide related disclosures do not apply to immaterial items.

Additionally, ASC 220-40 does not override materiality conclusions previously reached. Therefore, if an entity has previously concluded that a particular disclosure under other U.S. GAAP is not required due to a lack of materiality under ASC 105, that conclusion also applies to its inclusion in the tabular disaggregation required under ASC 220-40 (see Section 2.5).

VOLUNTARY DISCLOSURES ARE PRESENTED SEPARATELY

Entities may provide voluntary disclosures in addition to the required disaggregation disclosures when such information is decision-useful. Such disclosures may be presented either within the table or outside it; however, to preserve comparability across entities, voluntary disclosures must be presented separately from required disclosures. Those amounts must **not** be aggregated with the disaggregation amounts required under ASC 220-40.

Example 2-1 demonstrates the process by which an entity identifies relevant expense captions.

EXAMPLE 2-1: IDENTIFYING RELEVANT EXPENSE CAPTIONS

FACTS

An entity presents the following expense captions on the face of its consolidated income statement for the year ended December 31, 20X5, and the material components of those expense captions include the following:

EXPENSE CAPTION	COMPONENTS
Cost of sales	Purchases of inventory Employee compensation Other production costs
Selling and marketing	Employee compensation Depreciation of office equipment Advertising and other expenses
General and administrative	Employee compensation Intangible asset amortization Depreciation of office equipment Professional fees and other expenses

EXPENSE CAPTION	COMPONENTS
Depreciation	Depreciation expense on manufacturing equipment under ASC 360, *Property, Plant, and Equipment*
Intangible asset amortization	Intangible asset amortization expense under ASC 350-30, *Intangibles — Goodwill and Other — General Intangibles Other Than Goodwill*
Restructuring charges	One-time employee termination benefits Contract termination and other restructuring costs

CONCLUSION

Cost of sales, selling and marketing, general and administrative, and restructuring charges are relevant expense captions that must be disaggregated in the tabular disclosure. Although depreciation and intangible asset amortization are also relevant expense captions, they do not require additional disaggregation because the information presented on the face of the income statement satisfies the disclosure objective.

ANALYSIS

A relevant expense caption is an expense caption presented on the face of the income statement that contains any of the required expense categories identified in Section 2.3. The entity evaluates each income statement caption as follows:

EXPENSE CAPTION	RELEVANT EXPENSE CAPTION?	REASON
Cost of sales	Yes	Contains purchases of inventory and employee compensation.
Selling and marketing	Yes	Contains employee compensation and depreciation.
General and administrative	Yes	Contains employee compensation, depreciation, and intangible asset amortization.
Depreciation	Yes, but no additional disclosure required	Consists entirely of one required expense category already separately identified on the face of the income statement.
Intangible asset amortization	Yes, but no additional disclosure required	Consists entirely of one required expense category already separately identified on the face of the income statement.
Restructuring	Yes, and amounts must each be disclosed separately from other employee compensation.	Contains employee compensation in the form of one-time employee termination benefits. Also contains other exit or disposal activities that must be separately disclosed in accordance with other U.S. GAAP (see Section 2.5.1).

2.3.1 Natural Versus Functional Expenses

FASB REFERENCES

ASC 220-40-20: *Natural Expense Classification*

> *A method of grouping expenses according to the kinds of economic benefits received in incurring those expenses. Examples of natural expense classifications include salaries and wages, employee benefits, professional services, supplies, interest expense, rent, utilities, and depreciation.*

Master Glossary: *Functional Expense Classification*

> *A method of grouping expenses according to the purpose for which costs are incurred. The primary functional classifications of a not-for-profit entity are program services and supporting activities.*

Although the expenses typically presented on the income statement are functional expenses, the required expense categories prescribed by ASC 220-40 are natural expenses.

NATURAL EXPENSES	FUNCTIONAL EXPENSES
Natural expenses are distinguishable based on the types of **economic benefits** received in incurring those expenses.	Functional expenses are distinguishable based on the **purpose** for which the expenses are incurred.
Examples of natural expenses include: ▶ The required expense categories under ASC 220-40 ▶ Salary and wages ▶ Employee benefits ▶ Professional services ▶ Supplies ▶ Rent ▶ Utilities	Examples of functional expenses include: ▶ Cost of sales ▶ Cost of services ▶ Manufacturing and production ▶ SG&A ▶ R&D ▶ Marketing ▶ Distribution
Each natural expense category is associated with distinct economic benefits. For example, salary and wages yield the economic benefits associated with employee services, including labor hours and expertise. On the other hand, rent yields the economic benefits associated with the use of a building, including storage capacity and office space.	Each functional expense reflects a distinct business purpose. For example, cost of sales reflects the business purpose of generating revenue. On the other hand, R&D reflects the business purpose of developing new products, services, and technologies.

A functional expense caption may contain multiple natural expenses, and a natural expense may be allocated across multiple functional expense captions. The allocation of a natural expense across multiple functional expense captions does not affect its underlying natural expense category. For example, allocating employee compensation costs to both cost of sales and R&D does not change the natural classification of the expense, which remains employee compensation.

Natural expense categories align with the nature of the expense when recognized in the income statement, regardless of how the underlying cost was previously classified. In other words, when a cost is capitalized as an asset, any expense that is subsequently recognized would have a different natural classification than the cost that was capitalized. For example, commission paid to an employee that is capitalized as an incremental cost to obtain a contract with a customer in accordance with ASC 340-40, *Other Assets and Deferred Costs — Contracts with Customers,* is subsequently recognized as an amortization expense and does not retain its original natural classification as employee compensation (see Section 2.4.1). The exception to this principle is inventory disaggregated under the cost-incurred basis (see Section 2.3.2.1).

2.3.2 Purchases of Inventory

FASB REFERENCES

ASC 220-40-50-7

The first required expense category under ASC 220-40 is purchases of inventory. For the purposes of tabular disaggregation, this category is limited to costs within the scope of ASC 330, and related industry guidance. In other words, it only includes inventory purchases that occur within the ordinary course of business. All other inventory purchases must be excluded from the purchases of inventory category in the disaggregation table and presented in the other items category instead.

The table below summarizes which costs must be included in or excluded from the purchases of inventory category.

INCLUDED IN PURCHASES OF INVENTORY	EXCLUDED FROM PURCHASES OF INVENTORY
▶ Costs within the scope of ASC 330, such as: • Finished goods • Work-in-process • Purchases of raw materials ▶ Costs within the scope of ASC 330 Industry Subtopics (for example, ASC 905-330, *Agriculture — Inventory*)	▶ Costs recognized in a business combination within the scope of ASC 805, *Business Combinations* (see BDO's Blueprint, **Business Combinations Under ASC 805**) ▶ Costs recognized in a joint venture formation within the scope of ASC 805-60, *Business Combinations — Joint Venture Formations* (see Appendix D of BDO's Blueprint, **Business Combinations Under ASC 805**) ▶ Costs recognized in the initial consolidation of a variable interest entity that is not a business combination, within the scope of ASC 810, *Consolidation* (see Section 7.2.2 of BDO's Blueprint, **Control and Consolidation Under ASC 810**) ▶ Costs related to assets that are not recognized as inventory under ASC 330, even if such costs are described as inventory in practice (for example, film costs and costs accumulated for long-term construction contracts)

Amounts excluded from purchases of inventory are included in the other items category, unless other U.S. GAAP requires separate disclosure (see Section 2.5) or they are voluntarily presented separately (see Section 2.7).

An entity may disclose purchases of inventory (as defined above) using **either**:

Cost-incurred basis
(see Section 2.3.2.1)

→ Amounts disclosed include the following:
- Costs capitalized to inventory in the current reporting period
- Costs directly expensed in the current reporting period

Expense-incurred basis
(see Section 2.3.2.2)

→ Amounts disclosed include the following:
- Expenses related to derecognition of inventory in the current reporting period
- Costs directly expensed in the current reporting period

Whichever basis of accounting is applied for purchases of inventory must be applied to every required expense category (see Section 2.3.1).

If an entity changes its selected basis, prior-period disclosures must be recast to reflect the current-period basis, unless it is impracticable. If recasting is impracticable, the entity discloses that fact and explains the reason. A change between a cost-incurred basis and an expense-incurred basis does not represent a change in accounting principle under ASC 250, *Accounting Changes and Error Corrections*. See Section 2.9 for guidance on presenting such changes.

In some cases, a relevant expense caption that includes inventory-related amounts (often titled "purchases" or "purchases of materials") might qualify for a practical expedient that exempts it from disaggregation (see Section 2.3.2.3).

2.3.2.1 Cost-Incurred Basis

FASB REFERENCES

ASC 220-40-50-31(a) and ASC 220-40-50-32 through 50-34

Relevant expense captions that include purchases of inventory can be accounted for under a cost-incurred basis or an expense-incurred basis. Under the cost-incurred basis, disaggregated amounts disclosed include **both**:

- Costs capitalized to inventory in the current reporting period in accordance with ASC 330.
- Costs incurred during the current reporting period that were directly expensed, including costs that are capitalizable under ASC 330 but were directly expensed to the income statement.

The ability to disclose required expenses on a cost-incurred basis applies only to relevant expense captions that include inventory-related amounts. If an entity chooses to account for purchases of inventory using a cost-incurred basis, it must also apply that basis to the other required expense categories included within the relevant expense caption, such as employee compensation, intangible asset amortization, and depreciation (see Example 2-2). Under this basis, an entity discloses inventory-related costs based on their natural expense category when initially incurred.

Amounts disclosed under a cost-incurred basis often differ from expenses recognized during the reporting period. In such cases, the entity must reconcile the costs incurred to the total relevant expense caption. Therefore, it also discloses the following:

- Changes in inventories
- Other adjustments and reconciling items

The amount disclosed for changes in inventories in the current reporting period is calculated as follows:

Inventory balance at the end of the **prior** reporting period	−	Inventory balance at the end of the **current** reporting period	=	Changes in inventories in the current reporting period

The amount disclosed for other adjustments and reconciling items may include the following (presuming they are not presented separately):

- Inventory derecognized during the period that did not result in an expense recognition (for example, inventory derecognized as part of the sale of a business or other derecognition transactions within the scope of ASC 810 as discussed in Section 7.5 of BDO's Blueprint, Control and Consolidation Under ASC 810)
- Differences in the foreign currency exchange rates (for example, those used to translate costs incurred and those used to translate the beginning and ending inventory balance in accordance with ASC 830-30, *Foreign Currency Matters — Translation of Financial Statements*)

Consistent with the requirements for disclosing other items (see Section 2.7), an entity must provide, in both interim and annual reporting periods, a qualitative description of the nature of the items included in other adjustments and reconciling items. When applicable, the description must be based on their natural expense classification.

BDO INSIGHT 2-4: IMPAIRMENT AND SIMILAR CHARGES UNDER THE COST-INCURRED APPROACH

ASC 220-40 does not specify how to present inventory impairment, obsolescence, spoilage, or similar charges in the tabular format disclosure under the cost-incurred approach. Because such charges represent expenses that directly affect the change in inventory balance during the period, we generally believe that the most appropriate approach is to present them in the changes in inventory line item.

Alternatively, an entity might elect to present such charges in the other adjustments and reconciling items line item, along with a qualitative disclosure.

Determining the best way to present impairment and related charges requires the application of professional judgment based on the facts and circumstances.

Example 2-2 demonstrates the cost-incurred approach.

EXAMPLE 2-2: DISCLOSURE OF PURCHASES OF INVENTORY ON COST-INCURRED BASIS

FACTS

- A multinational entity manufactures furniture.
- On its income statements for the years ended December 31, 20X4 and December 31, 20X3, the entity presents cost of goods sold in the amounts of $35,000 and $28,000, respectively.
- During the years ended December 31, 20X4 and 20X3, the entity incurs manufacturing costs as follows:

COST INCURRED		20X4		20X3
Purchases of inventory	$	17,000	$	21,500
Employee compensation		12,500		10,000
Total costs incurred	$	29,500	$	31,500

- All costs are capitalized to inventory in accordance with ASC 330.
- The balance sheet inventory amount decreased by $6,000 during 20X4 and increased by $2,700 during 20X3.
- Amounts attributable to differences in foreign currency exchange rates used for translation were ($500) in 20X4 and ($800) in 20X3.
- The entity applies the cost-incurred basis to disaggregate cost of goods sold in accordance with ASC 220-40.

CONCLUSION

- The entity makes the following disclosure for cost of goods sold for the year ended December 31, 20X4:

	DECEMBER 31, 20X4		DECEMBER 31, 20X3	
Purchases of inventory	$	17,000	$	21,500
Employee compensation		12,500		10,000
Changes in inventory		6,000		(2,700)
Other adjustments and reconciling items[a]		(500)		(800)
Total cost of goods sold	$	35,000	$	28,000

[a] Other adjustments and reconciling items include differences in the foreign exchange rates to translate inventory balances into the reporting currency for 20X4 and 20X3.

ANALYSIS

- The entity identifies cost of goods sold as a relevant expense caption because it includes expenses related to purchases of inventory and employee compensation.
- Under the cost-incurred basis, the entity:
    - Discloses costs incurred during the current reporting period that were both capitalized to inventory and directly expensed.
    - Applies the cost-incurred basis to disaggregate all required expense categories within cost of goods sold.
    - Discloses changes in inventory and other adjustments and reconciling items as separate line items within the tabular format.
    - Provides qualitative disclosure to accompany other adjustments and reconciling items.

BDO INSIGHT 2-5: COST-INCURRED INVENTORY DISCLOSURES

Under the cost-incurred basis, the required natural categories may include both amounts capitalized to inventory and amounts expensed as incurred. Accordingly, the changes in inventories and other adjustments and reconciling items lines are necessary to reconcile current-period costs incurred to expense recognized. Entities may need inventory and production reports, standard-cost or manufacturing systems, acquisition data, and foreign-currency translation information. If an entity cannot extract precise data for all the required inputs, it may estimate amounts that reasonably approximate the required disclosures (see BDO Insight 2-2).

Determining which values are required to reconcile current-period costs incurred to expense recognized requires the application of professional judgment based on the facts and circumstances.

2.3.2.2 Expense-Incurred Basis

FASB REFERENCES

ASC 220-40-50-31(b)

Relevant expense captions that include purchases of inventory can be accounted for under a cost-incurred basis or an expense-incurred basis. Under the expense-incurred basis, disaggregated amounts disclosed include **both**:

- Expenses related to the derecognition of inventory that was previously capitalized in accordance with ASC 330.
- Costs incurred during the current reporting period that were directly expensed, including costs that are capitalizable under ASC 330 but were directly expensed to the income statement.

Under this basis, an entity discloses expenses from the derecognition of inventory based on the natural expense category of the costs when initially incurred. For example, expenses from the derecognition of inventory could relate to purchases of inventory and employee compensation incurred in prior periods (see Example 2-3).

Example 2-3 demonstrates the expense-incurred approach.

EXAMPLE 2-3: DISCLOSURE OF PURCHASES OF INVENTORY ON EXPENSE-INCURRED BASIS

FACTS

- An entity manufactures a medical device that recently received U.S. Food and Drug Administration approval.
- On its income statements for the years ended December 31, 20X4 and December 31, 20X3, the entity presents cost of goods sold in the amounts of $775,000 and $0, respectively.
- During the year ended December 31, 20X3, the entity produces 500 units of the medical device as follows:

UNIT COST	BATCH 1	BATCH 2
Purchases of inventory	$ 1,300	$ 1,600
Employee compensation	700	900
Total unit cost	$ 2,000	$ 2,500
Units produced	200	300
Total batch cost	$ 400,000	$ 750,000

- No units are sold during 20X3. All costs are capitalized to inventory in accordance with ASC 330.

- During the year ended December 31, 20X4, the entity sells 350 units of the medical device, consisting of:
  - 200 units from Batch 1
  - 150 units from Batch 2
- The entity applies the expense-incurred basis to disaggregate cost of goods sold in accordance with ASC 220-40.

CONCLUSION

- The entity disaggregates cost of goods sold for the year ended December 31, 20X4 as follows:

	DECEMBER 31, 20X4	DECEMBER 31, 20X3
Purchases of inventory	$ 500,000	$ —
Employee compensation	275,000	—
Total cost of goods sold	$ 775,000	$ —

ANALYSIS

- The entity identifies cost of goods sold as a relevant expense caption because it includes expenses related to purchases of inventory and employee compensation.
- Under the expense-incurred basis, the entity discloses amounts related to inventory derecognized in the period and classifies those expenses based on the natural expense category of the costs when they were initially incurred.
- Purchases of inventory amounts recognized in 20X4 consist of:
  - Batch 1: 200 units x $1,300 = $260,000
  - Batch 2: 150 units x $1,600 = $240,000
  - Total purchases of inventory = $500,000
- Employee compensation amounts recognized in 20X4 consist of:
  - Batch 1: 200 units x $700 = $140,000
  - Batch 2: 150 units x $900 = $135,000
  - Total employee compensation = $275,000
- No disaggregation is presented for 20X3 because no inventory was derecognized and the entity did not recognize cost of goods sold during that period.
- The disclosure does not include a “changes in inventories” category because the entity applies the expense-incurred basis.

2.3.2.3 Practical Expedient for Purchases of Inventory

FASB REFERENCES

ASC 220-40-50-19

In some cases, a relevant expense caption (often titled “purchases” or “purchases of materials”) might include both amounts within the scope of ASC 330 and amounts related to purchases of items other than inventory (for example, purchases of property, plant, and equipment). As a practical expedient, when substantially all of a relevant expense caption comprises purchases of inventory within the scope of ASC 330, the entity is not required to disaggregate that expense caption into required expense categories. For example, inventory purchases may comprise substantially all of the amount reported as cost of goods sold for a reseller. However, if the threshold for “substantially all” is not met

(see BDO Insight 2-6), the exception from disaggregation does not apply and the entity must disaggregate the expense caption into required expense categories.

An entity that applies the practical expedient must disclose a qualitative description of the composition of the expense caption in both interim and annual reporting periods, instead of disclosing disaggregated amounts for that expense caption.

BDO INSIGHT 2-6: "SUBSTANTIALLY ALL" THRESHOLD

ASC 220-40 does not quantify or define the term "substantially all." However, the threshold generally is understood as approximately 90%, consistent with application in other U.S. GAAP (for example, ASC 842, *Leases*).

2.3.3 Employee Compensation

FASB REFERENCES

ASC 220-40-20: Employee, Employee Compensation, ASC 220-40-50-8, and ASC 220-40-50-21(e)

The second required expense category under ASC 220-40 is employee compensation. ASC 220-40 defines employee compensation broadly to capture the most common types of consideration paid, granted, or issued to employees in exchange for services. It defines employee in a manner consistent with the Master Glossary definition of the same term in ASC 718, *Compensation — Stock Compensation*. The definition of employee establishes the population to which employee compensation relates, and the definition of employee compensation establishes the types of consideration included for that population.

ASC 220-40 and ASC 718 both define an employee as an individual over whom a reporting entity exercises, or has the right to exercise, sufficient control to establish an employer-employee relationship based on common law. The definition includes, but is not limited to, full-time, part-time, temporary, and seasonal employees and may also include inactive employees. For the full definition of employee and factors used in determining whether an individual is an employee under common law, see Section 1.3 of BDO's Blueprint, Share-based Payments Under ASC 718.

ASC 220-40 defines employee compensation as all forms of cash and noncash compensation provided by an entity in exchange for employee services, or for the termination of employment. The definition also encompasses any costs recognized in accordance with ASC 710, *Compensation — General*, ASC 712, *Compensation — Nonretirement Postemployment Benefits*, ASC 715, *Compensation — Retirement Benefits* (including defined contribution plans and multiemployer plans), and ASC 718.

Employee compensation includes (but is not limited to) the following:

Cash consideration	▶ Wages ▶ Salaries ▶ Bonuses ▶ Profit-sharing compensation ▶ One-time employee termination benefits ▶ Deferred cash compensation
Share-based payment arrangements	▶ Share-based payments (for example, stock options and restricted stock) ▶ Employee stock ownership plans ▶ Employee share purchase plans

Employee benefits [1]	▶ Vacation and other paid time off ▶ Medical insurance ▶ Pensions ▶ Retirement benefits ▶ Nonretirement postemployment benefits (including special or contractual termination benefits)
Government and social insurance payments	▶ Unemployment insurance ▶ Accident, injury, and illness insurance ▶ Old-age, disability, and survivors' insurance (e.g., social security) ▶ Family allowances (e.g., child and dependent tax payments) ▶ Reimbursements for medical and hospital expenses (e.g., Medicare tax payments)

The employee compensation expense category is limited to services rendered by employees. Compensation related to nonemployees such as contract laborers and professional service providers is **excluded** from employee compensation.

Although nonemployee members of an entity's board of directors do not meet the definition of a common law employee, they are considered employees for accounting purposes under a limited exception in the employee definition. Specifically, board members are treated as employees if **both** of the following apply:

- They were elected by the entity's shareholders or appointed to a board position that will be filled via shareholder election when the existing term expires.
- They provide services solely in their role as a board member.

Individuals that provide advisory or consulting services in a nonelected capacity or provide such services beyond their role as a board member (for example, legal, marketing, or investment banking advice) are treated as nonemployees.

BDO INSIGHT 2-7: NONEMPLOYEE COMPENSATION MAY BE VOLUNTARILY DISCLOSED

A relevant expense caption might include both employee and nonemployee compensation. Although ASC 220-40 only requires an entity to disaggregate **employee** compensation, it does not preclude an entity from disaggregating **nonemployee** compensation, as well. However, if disclosed, nonemployee compensation must be presented separately from employee compensation and the other required expense categories.

We believe that an entity may elect to disclose nonemployee compensation either in a separate line item within the tabular disclosure or outside of the tabular disclosure. Depending on the extent to which an entity relies on contract labor, disclosure preferences might differ, even among entities in similar industries or markets.

Determining whether and in which manner to disclose nonemployee compensation requires the application of professional judgment based on the facts and circumstances.

An entity may elect (but is not required) to include amounts attributable to other transactions entered for the benefit of employees (for example, the provision of subsidized goods or services) within employee compensation. If an entity includes such amounts, it must disclose its election for both interim and annual reporting periods, including **both**:

- A statement that additional transactions have been included in employee compensation
- A description of those transactions

[1] For defined benefit plans within the scope of ASC 715, employee compensation includes only the service cost component of net periodic pension cost and the service cost component of net periodic postretirement benefit cost.

A relevant expense caption might also include one-time employee termination benefits. An entity must disclose those benefits separately from other elements of employee compensation in accordance with the existing disclosure requirements for exit or disposal activities (see Section 2.5.1).

2.3.3.1 Practical Expedient for Employee Compensation

FASB REFERENCES

ASC 220-40-50-20 and ASC 942-220-S99-1

Rule 9-04 of Regulation S-X requires banks and bank holding companies within the scope of ASC 942, *Financial Services — Depository and Lending* to separately present salaries and employee benefits expenses, either on the face of the income statement or in the footnotes, if quantitative criteria are met.

As a practical expedient, entities that separately present or disclose those amounts in accordance with Regulation S-X may use them to comply with the disaggregation requirements under ASC 220-40 rather than determining employee compensation in accordance with the definition in ASC 220-40.

BDO INSIGHT 2-8: EMPLOYEE COMPENSATION PRACTICAL EXPEDIENT

An entity with diversified operations including financial services and other business lines (for example, telecommunications or product sales) might present the following income statement captions:

- A salary and benefits line item related to the financial services business in accordance with Rule 9-04
- Separate captions that include employee compensation (such as cost of goods sold or sales and marketing expense) related to other business lines

We believe the entity can apply the employee compensation practical expedient for the caption that complies with Rule 9-04. The entity must disaggregate any other relevant expense captions in accordance with the guidance in Section 2.3.3. The entity may also consider disclosing its use of the practical expedient for financial services in the notes to the financial statements.

Deciding whether to apply the employee compensation practical expedient to applicable expense captions requires the application of professional judgment based on the facts and circumstances.

2.3.4 Depreciation and Intangible Asset Amortization

FASB REFERENCES

ASC 220-40-50-9 through 50-10 and ASC 842-20-45-4(a)

The third and fourth required expense categories under ASC 220-40 are depreciation and intangible asset amortization. Depreciation and amortization amounts disclosed must satisfy and be disclosed on a consistent basis with existing disclosure requirements for total depreciation expense under ASC 360, and total intangible asset amortization expense under ASC 350-30.

For example, manufacturing equipment is subject to disclosure requirements in ASC 360 and accordingly is included in depreciation for the purposes of applying ASC 220-40. Similarly, amortization of specific capitalized software costs within the scope of ASC 985-20, *Software — Costs of Software to Be Sold, Leased, or Marketed*, is subject to disclosure

requirements in ASC 350-30, and accordingly is included in intangible asset amortization for the purposes of applying ASC 220-40.

Under ASC 220-40, all expenses described as "amortization" must be disclosed in the tabular disaggregation. However, some of those expenses may be disclosed as either depreciation or intangible asset amortization, based on the entity's policies on classifying those expenses in the income statement. For example:

- Amortization of a right-of-use asset for finance leases and leasehold improvements recognized in accordance with ASC 842 (see Section 8.2.2 of BDO's Blueprint, **Accounting for Leases Under ASC 842**)
- Amortization of internal-use software within the scope of ASC 350-40, *Intangibles — Goodwill and Other — Internal-Use Software* (see Sections 3.3.2 and 4.3.2 of BDO's Blueprint, **Accounting for Software Costs**)

Classification as either depreciation or intangible asset amortization must be consistently applied.

For other assets subject to amortization, an entity must classify the related expense as depreciation or intangible asset amortization based on the nature of the underlying asset and other applicable U.S. GAAP. However, in cases in which depreciation or intangible asset amortization is capitalized as a noninventory asset, the total amounts disclosed in accordance with ASC 220-40 might not equal the total amounts disclosed in each respective footnote in accordance with ASC 360 and ASC 350-30.

2.3.5 Depreciation, Depletion and Amortization — Extractive Activities

FASB REFERENCES

ASC 220-40-50-11

The fifth required expense category under ASC 220-40 is DD&A of capitalized acquisition, exploration, and development costs recognized as part of oil- and gas-producing activities or other amounts of depletion expense. This expense category is relevant to entities operating in extractive industries. For purposes of disaggregation disclosures within the DD&A expense caption, an entity includes depletion expense recognized as part of:

- Oil and gas-producing activities under ASC 932-360, *Extractive Activities — Oil and Gas — Property, Plant, and Equipment*
- Other extractive activities, including by entities within the scope of ASC 930, *Extractive Activities — Mining*.

2.4 EXPENSES EXEMPT FROM DISAGGREGATION

Under ASC 220-40, the following expenses are exempt from the disaggregation requirement:

- Noninventory amounts capitalized as an asset (see Section 2.4.1)
- Amounts related to specific liabilities (see Section 2.4.2)
- Amounts related to equity method investments (see Section 2.4.3)

2.4.1 Specific Asset-Related Expenses

FASB REFERENCES

ASC 220-40-50-14 through 50-15

The disaggregation requirements under ASC 220-40 do not apply to noninventory costs capitalized as an asset, even if the costs capitalized include one or more required expense categories (see Section 2.3). [2] When an expense amount relates to the derecognition of an asset other than inventory, the entity must apply the disaggregation requirements based on the nature of the expense at the time of recognition in the income statement. [3]

For example, an entity is not required to disaggregate employee compensation capitalized to any of the following:

- Costs to obtain or fulfill a contract with a customer
- Self-constructed property, plant, and equipment for internal use
- Internal-use software

Instead, an entity discloses subsequent depreciation or amortization of those and other asset categories when incurred, without further disaggregation to required expense categories.

2.4.2 Specific Liability-Related Expenses

FASB REFERENCES

ASC 220-40-50-16 through 50-18

The disaggregation requirements under ASC 220-40 do not apply to liability-related expenses if **all** the following criteria are met:

- The expense relates to an obligation to be settled in the future and there is uncertainty about the timing of settlement.
- The expense relates to an obligation based on an estimate of a future expenditure.
- The expense is not entirely made up of one required expense category (for example, employee compensation).

Liability-related expenses that meet the above criteria are excluded from disaggregation into specified expense categories, even when included within a relevant expense caption. However, if such expenses are subject to separate disclosure requirements that require tabular integration, they are still included in the tabular format (see Section 2.5).

By contrast, expenses related to obligations for goods or services that have already been received or supplied, but which have not yet been paid or invoiced, do not meet the above criteria and thus remain subject to the disaggregation requirements under ASC 220-40.

---

[2] By contrast, the disaggregation requirements under ASC 220-40 do apply to purchases of inventory disclosed under a cost-incurred basis (see Section 2.3.2.1).

[3] By contrast, an entity discloses expenses from the derecognition of inventory based on the natural expense category of the costs when initially incurred (see Section 2.3.2.2).

The table below provides examples of expenses that meet and do not meet the above criteria.

EXAMPLES OF EXPENSES THAT MEET THE ABOVE CRITERIA (NO DISAGGREGATION REQUIRED)	EXAMPLES OF EXPENSES THAT DO NOT MEET THE ABOVE CRITERIA (DISAGGREGATION REQUIRED)
▶ Provision for losses on contracts (such as those under ASC 605-35, *Revenue Recognition — Construction-Type and Production-Type Contracts*) ▶ Claims and claims adjustment expenses (for example, in the insurance industry) ▶ Asset retirement obligations	▶ Accrued compensation such as bonuses or vacation pay ▶ Pension-related obligations ▶ Other accrued liabilities for goods or services received or supplied but not yet paid or invoiced

NOT ALL LIABILITY-RELATED ESTIMATES ARE EXEMPT FROM DISAGGREGATION

The presence of an **estimate**, which is common in many ongoing and recurring financial reporting activities, is not sufficient to qualify an expense for exemption from disaggregation. To qualify for exemption, the expense must also relate to an obligation for **future expenditures** where the amount and timing of settlement are **uncertain**. In addition, the expense must not be entirely made up of one required expense category.

Expenses such as claims and claim adjustment expenses meet this threshold. However, expenses related to obligations for goods or services already received or supplied do not meet this threshold, even when measured using estimates. For example, employee-related accrued bonuses, vacation pay, or pension obligations reflect costs where the amount and timing of settlement are known and therefore remain subject to disaggregation.

2.4.3 Equity Method Investments

FASB REFERENCES

ASC 220-40-50-13

Equity method income or loss is not a relevant expense caption (see Section 2.2). Accordingly, an entity's share of earnings or losses from investments accounted for under the equity method in accordance with ASC 323, *Investments — Equity Method and Joint Ventures* is exempt from the disaggregation requirements under ASC 220-40. Additionally, an entity is not required to further disaggregate any of the disclosures required by ASC 323 (see Section 6.3 of BDO's Blueprint, Equity Method Investments Under ASC 323).

2.5 INTEGRATION OF EXISTING DISCLOSURE REQUIREMENTS

FASB REFERENCES

ASC 205-10-50-1 and ASC 220-40-50-23 through 50-25

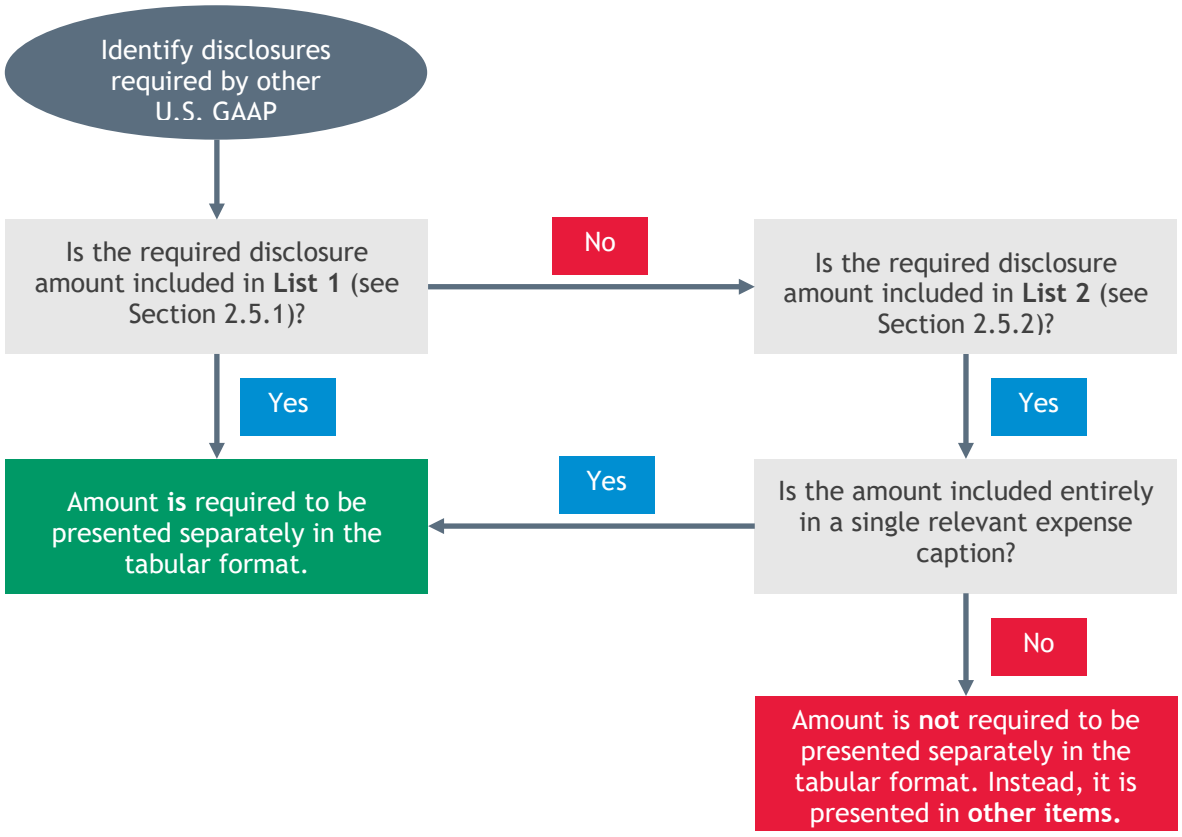
As previously discussed, the required expense disclosures under ASC 220-40 must be presented in a tabular format. To assist investors by enhancing the relevance of that tabular format, an entity must also integrate disclosures required by other U.S. GAAP (that is, disclosures required by Topics other than ASC 220-40) into the tabular format when those items are included within a relevant expense caption. An entity includes the disclosures listed in this Section 2.5 for annual reporting periods, and for interim reporting purposes when other U.S. GAAP requires such disclosures in interim periods.

The disclosures that must be integrated into the tabular format (only when they are included within a relevant expense caption) constitute two separate lists:

- **List 1:** Items for which both the amount and income statement caption where the amount is recorded are required disclosures under other U.S. GAAP ("amounts with income statement mapping") (see Section 2.5.1)
- **List 2:** Items that are only disclosed if the entire amount is recorded in a single expense caption that is already identified as a relevant expense caption ("amounts without income statement mapping") (see Section 2.5.2)

The presence of such items does not, by itself, cause an expense caption to be a relevant expense caption (see Section 2.2).

The diagram below summarizes the steps to integrate other required disclosures into the tabular format:



2.5.1 Amounts with Income Statement Mapping

FASB REFERENCES

ASC 220-40-50-21

An entity must include specified expenses, gains, and losses recognized under other U.S. GAAP in the tabular format required by ASC 220-40 (see Section 2.5). The specified items constitute two separate lists.

List 1 consists of amounts **with income statement mapping**. In other words, for each item on List 1, the entity is required by other U.S. GAAP to disclose both the amount recognized and the income statement caption in which the amount is recognized. If an item from List 1 is included within a relevant expense caption, it must be incorporated into the tabular format and presented as a **separate** category.

In applying this disclosure requirement:

If the disclosed amount is included within a relevant expense caption	→	It is required to be presented separately in the tabular format.
If the disclosed amount is not included in a relevant expense caption	→	It is not required to be presented in the tabular format. The entity applies the disclosure requirements of other U.S. GAAP.

For example, ASC 926-20, *Entertainment — Films — Other Assets — Film Costs*, requires an entity to disclose the amount of amortization of film costs and the income statement caption in which the amortization is recognized. Therefore, if the amortization of film costs is included in a relevant expense caption, it is required to be incorporated into and separately presented in the tabular format.

Disclosure requirements for List 1 items, along with their respective applicable guidance, are listed in the table below:

DISCLOSURES PRESENTED SEPARATELY IN THE TABULAR FORMAT (LIST 1)	REFERENCES
The amount of R&D assets acquired in a transaction other than a business combination and written off	ASC 350-30-50-1(c)
Impairments of intangible assets (see BDO's Blueprint, **Impairments under ASC 350 and ASC 360**, for more guidance)	ASC 350-30-50-3
Impairments of long-lived assets classified as held and used (see BDO's Blueprint, **Impairments under ASC 350 and ASC 360**, for more guidance)	ASC 360-10-50-2
Gain or loss recognized for long-lived assets classified as held for sale or disposed of (see Appendix A of BDO's Blueprint, **Revenue Recognition Under ASC 606**, and BDO's Blueprint, **Impairments under ASC 350 and ASC 360**, for more guidance)	ASC 360-10-50-3

DISCLOSURES PRESENTED SEPARATELY IN THE TABULAR FORMAT (LIST 1)	REFERENCES
Each major type of cost associated with an exit or disposal activity (for example, one-time employee termination benefits, contract termination costs, and other associated costs)	ASC 420-10-50-1
Components of net benefit cost recognized (other than service cost amounts included within employee compensation)	ASC 715-20-50-1(h)
Bargain purchase gain recognized in a business combination (see BDO's Blueprint, **Business Combinations Under ASC 805**, for more guidance)	ASC 805-30-50-1(f)
Gain or loss recognized upon the deconsolidation of a subsidiary or the derecognition of a group of assets, either of which is a business or nonprofit activity (see BDO's Blueprint, **Control and Consolidation Under ASC 810**, for more guidance)	ASC 810-10-50-1B
Gain or loss on derivative instruments, and nonderivative instruments that are designated and qualify as hedging instruments in accordance with ASC 815-20, *Derivatives and Hedging, Hedging — General*, and related hedged items	ASC 815-10-50-4A
Total expense recognized for environmental credits not initially recognized as an asset; impairments of environmental credit assets; and total expense recognized for environmental credit obligation liabilities (see BDO's Bulletin, **Environmental Credit Guidance Established Under ASC 818**, for more guidance and effective dates)	ASC 818-20-50-3(a), ASC 818-20-50-3(b), and ASC 818-30-50-3
The total government grants recognized during the reporting period and presented as a deduction from the related expense (see BDO's Bulletin, **New Government Grant Accounting for Businesses**, for more guidance and effective dates)	ASC 832-10-45-1(b), ASC 832-10-45-3(b), and ASC 832-10-50-3A
Amortization and impairments of license agreements for program material	ASC 920-350-50-2 and ASC 920-350-50-4
Amortization and impairments of film costs	ASC 926-20-50-4A and ASC 926-20-50-4C

The disclosures listed in the table above must be included in the tabular format using the same reporting frequency (either interim and annual or only annual) as required by the respective guidance.

2.5.2 Amounts Without Income Statement Mapping

FASB REFERENCES

ASC 220-40-50-22

An entity must include specified expenses, gains, and losses recognized under other U.S. GAAP in the tabular format required by ASC 220-40 (see Section 2.5). The specified items constitute two separate lists.

List 2 consists of amounts **without income statement mapping**. In other words, for each item on List 2, the entity is required by other U.S. GAAP to disclose the amount recognized, but not to identify the income statement caption in

which the amount is recognized. If an item from List 2 is included entirely within a single relevant expense caption, it must be incorporated into the tabular format and presented as a separate category.

In applying this disclosure requirement:

If the disclosed amount is included entirely in one relevant expense caption	→	It is required to be presented separately in the tabular format.
If the disclosed amount is included in multiple expense captions	→	It is not required to be presented separately in the tabular format. Instead, it is presented in other items (see Section 2.7) within each relevant expense caption.

For example, ASC 340-40 requires an entity to disclose the amount of amortization of costs to fulfill a contract with a customer, but it does not require the entity to identify the income statement caption in which the amortization is recognized. Therefore, if the amortization of costs to fulfill a contract with a customer is included entirely in one relevant expense caption, it is required to be incorporated into and separately presented in the tabular format.

Disclosure requirements for List 2 items, along with their respective applicable guidance, are listed in the table below:

DISCLOSURES PRESENTED SEPARATELY IN THE TABULAR FORMAT (LIST 2)	REFERENCES
Provision for expected credit losses	ASC 326-20-50-13 and ASC 326-30-50-9
Losses on firm purchase commitments	ASC 330-10-50-5
Amortization expense attributable to the expiration of insurance or reinsurance coverage provided under a contract that transfers only significant underwriting risk	ASC 340-30-50-2
Amortization or impairment of costs to obtain or fulfill a contract with a customer (see Section 8.3.6 of BDO's Blueprint, **Revenue Recognition Under ASC 606**, for more guidance)	ASC 340-40-50-3
Amortization of capitalized implementation costs of hosting arrangements that are service contracts (see Section 4.3.2 of BDO's Blueprint, **Accounting for Software Costs**, for more guidance)	ASC 350-40-50-3
Asset retirement obligation accretion expense	ASC 410-20-50-1
Loss contingencies recognized	ASC 450-20-50-1
Warranty expense — the total expense recognized for product warranties during the reporting period, comprising **both**: ▶ Costs related to warranties issued during the period ▶ Adjustments to previously recorded warranty obligations (including changes based on updated estimates)	ASC 460-10-50-8

DISCLOSURES PRESENTED SEPARATELY IN THE TABULAR FORMAT (LIST 2)	REFERENCES
Expense related to counterparty default in own-share lending arrangements issued in contemplation of convertible debt issuance	ASC 470-20-50-2C
Gain on restructuring of payables by a debtor with a troubled debt restructuring (see BDO's Blueprint, **Issuer's Accounting for Complex Financial Instruments**, for more guidance)	ASC 470-60-50-1
Gain or loss upon consolidation of a variable interest entity that is not a business (see BDO's Blueprint, **Control and Consolidation Under ASC 810**, for more guidance)	ASC 810-10-50-3
Foreign currency transaction gain or loss	ASC 830-20-50-1
Operating lease cost, short-term lease cost, variable lease cost, and net gain or loss recognized from sale and leaseback transactions (see BDO's Blueprint, **Accounting for Leases Under ASC 842**, for more guidance)	ASC 842-20-50-4
Gain or loss from nonmonetary transactions	ASC 845-10-50-1
Amortization of capitalized acquisition costs	ASC 944-30-50-1(c)

The disclosures listed in the above table must be included in the tabular format using the same reporting frequency (either interim and annual or only annual) as required by the respective guidance.

See Section 2.9 for guidance on changes in presentation of items in this section.

EXAMPLE 2-4: DISCLOSURES OF AMOUNTS WITHOUT INCOME STATEMENT MAPPING

FACTS

- An entity presents the following relevant expense captions on the face of its income statement:
  - Cost of product sales
  - Cost of service sales
- The entity recognizes warranty expense entirely within cost of product sales.
- The entity recognizes the amortization of costs to fulfill a contract with a customer in both cost of product sales and cost of service sales.

CONCLUSION

The entity incorporates and separately presents warranty expense in the tabular disclosure that disaggregates cost of product sales. The entity does not incorporate amortization of costs to fulfill a contract with a customer into the tabular disclosure; instead, amortization of costs to fulfill a contract with a customer is presented in other items.

ANALYSIS

- Amortization of costs to fulfill a contract with a customer and warranty expense are both included in List 2. For each item on List 2, the entity is required by other U.S. GAAP to disclose the amount recognized, but not to identify the income statement caption in which the amount is recognized.

- Because warranty expense is on List 2 and is included entirely within cost of product sales, a relevant expense caption, the entity must separately present that amount in the tabular disclosure that disaggregates cost of product sales.
- Because the amortization of costs to fulfill a contract with a customer is on List 2 and is recognized in multiple expense captions, the entity does not incorporate those amounts into the tabular disclosure that disaggregates the relevant expense captions. Instead, those amounts are presented in other items.
- Incorporating these disclosures into the tabular disclosure does not otherwise affect the disclosure requirements in other areas of U.S. GAAP.

2.6 EXPENSE REIMBURSEMENT AND COST SHARING ARRANGEMENTS

FASB REFERENCES

ASC 220-40-50-26 through 50-29

ASC 220-40 provides specific disclosure requirements for expense reimbursement and cost sharing arrangements (such as funded R&D and collaborative arrangements). Other U.S. GAAP does not specify where to present related costs or cost reimbursements in the income statement.

When a relevant expense caption includes amounts recorded net of an expense reimbursement related to a cost sharing or expense reimbursement arrangement **from** another entity, an entity must **either**:

- Separately disclose the amount of the expense reimbursement in the tabular format
- Disclose the amounts of the required expense categories in the tabular format, net of any reimbursement effects

An entity must also disclose which of the two formats it uses.

When an entity includes an expense reimbursement provided **to** another entity in a relevant expense caption, the entity **must** separately disclose the amount of that expense reimbursement in the same tabular format required by ASC 220-40.

When applying the above requirements, an entity must provide qualitative descriptions of the expense categories, based on their natural expense classification, to which an expense reimbursement relates. See Example 3-2.

Expense reimbursement and cost sharing disclosure requirements apply to interim and annual reporting periods.

BDO INSIGHT 2-9: COLLABORATIVE ARRANGEMENTS MAY INCLUDE IN-SCOPE EXPENSE REIMBURSEMENTS

A collaborative arrangement in the scope of ASC 808, *Collaborative Arrangements* is not automatically subject to the guidance for cost sharing and expense reimbursement arrangements under ASC 220-40. An entity should first determine the units of account and the appropriate recognition and income statement presentation under ASC 808 and other applicable U.S. GAAP. The guidance above only applies if a payment between collaborative arrangement participants is presented in a relevant expense caption as an expense reimbursement related to a cost sharing or expense reimbursement arrangement. Amounts presented outside a relevant expense caption or as revenue do not become subject to those provisions solely because the arrangement is in the scope of ASC 808.

2.7 OTHER ITEMS REMAINING IN RELEVANT EXPENSE CAPTIONS

FASB REFERENCES

ASC 220-40-50-30

Other items represents the remaining components within each relevant expense caption after an entity disaggregates required expense categories and integrates existing disclosures into the tabular format. An entity must include other items as a line item in the tabular format for each relevant expense caption. Other items disclosure requirements apply to interim and annual reporting periods.

Other items is the difference between the following:

- The relevant expense caption amount presented on the face of the income statement
- The aggregate amount of expense categories separately disclosed in the relevant expense caption, including:
    - Required expense categories (see Section 2.3)
    - Specified disclosures required by other U.S. GAAP (see Section 2.5)
    - Expense reimbursements (see Section 2.6)

An entity must also qualitatively describe the composition of other items based on natural expense classification. The detail provided in those qualitative disclosures must be commensurate with the significance of the items being described.

An entity is not precluded from further disaggregating relevant expense captions into additional, voluntary disclosures before determining the remaining other items. Additional voluntary disclosures may be provided inside or outside the tabular format.

2.8 SELLING EXPENSES

FASB REFERENCES

ASC 220-40-50-35 through 50-36

An entity must disclose the total selling expenses recognized in continuing operations in interim and annual reporting periods. An entity must also disclose how it defines “selling expenses” in annual reporting periods and must update the disclosure in interim reporting periods if the definition changes. An entity determines what constitutes selling expenses by applying judgment based on facts and circumstances, but that definition must include only items presented as expenses in the income statement. An entity applies disaggregation requirements to selling expenses only when it presents selling expenses as a separate caption on the face of the income statement and the caption is a relevant expense caption (see Section 2.2). When an entity does not present selling expenses as a separate caption, the entity does not further disaggregate the disclosed amount into the required expense categories.

When an entity changes its definition of selling expenses, it applies the guidance in Section 2.9.

BDO INSIGHT 2-10: CHANGE IN DEFINITION OF SELLING EXPENSES

Because U.S. GAAP does not define selling expenses, an entity's definition may change over time as disclosure practices develop or as its business model evolves. An entity must disclose when a change in its definition of selling expenses occurs, whether in an interim or annual reporting period.

A change in the definition of selling expenses does not represent a change in accounting principle in accordance with ASC 250.

2.9 PRESENTATION CHANGES

FASB REFERENCES

ASC 205-10-50-1 and ASC 220-40-50-4 through 50-5

An entity must apply the disclosure requirements in ASC 220-40 consistently for all periods presented. However, an entity might change how it presents information in ASC 220-40 disclosures in the current interim or annual period due to a **change** to any of the following:

- The election of an alternative (for example, a change between a cost-incurred basis and an expense-incurred basis for disaggregating inventory purchases; see Section 2.3.2).
- The definition of an expense category (for example, selling expenses; see Section 2.8).

In such circumstances, the entity must:

- Disclose the reason for the change in the period of the change, including in both interim and annual reporting periods affected.
- Either recast the prior comparative periods or, if recasting is impracticable, disclose that fact and explain the reason.

By contrast, an entity does **not** recast prior periods to conform changes in the population of disclosures required by other U.S. GAAP that are integrated into the tabular format (see Section 2.5). If changes in facts and circumstances cause an item in **List 2** (see Section 2.5.2) to move from being included in one relevant expense caption to multiple relevant expense captions, or from multiple relevant expense captions to one relevant expense caption, when compared with a prior period, the entity must provide the disclosures required by ASC 205, *Presentation of Financial Statements*.

As discussed in Section 2.2, an entity might present condensed statements for interim reporting periods, including different expense captions on the income statement. In that case, the entity must apply the disclosure requirements consistently to interim periods based on interim presentation, and to annual periods based on annual presentation.

Changes in how an entity presents information in ASC 220-40 disclosures described in this section do not represent a change in accounting principle in accordance with ASC 250.

Chapter 3: Illustrative Examples



3.1 OVERVIEW

ASC 220-40 includes three examples to illustrate the disaggregation of relevant expense captions (see Chapter 2) which are reproduced in this chapter.

3.2 ILLUSTRATIVE EXAMPLES

FASB REFERENCES

ASC 220-40-55-1 through 55-25

The three examples below have been reproduced from ASC 220-40 and are intended as examples only. That is, the examples do **not** represent a required format for the disclosures. Additionally, the examples may not illustrate incremental disclosure guidance otherwise applicable to an item or amount in accordance with other U.S. GAAP.[4]

ASC 220-40 allows an entity to use estimates or other methods that produce a reasonable approximation of the amounts required to be disclosed (see Section 2.3).

BDO INSIGHT 3-1: USE OF ESTIMATES

The FASB acknowledged broad stakeholder concerns about potential reporting system and process limitations in preparing the disclosures using transaction-level detail. As a result, the Board clarified that an entity can use estimates or other methods that produce a reasonable approximation of the required disclosure amounts.

In accordance with this guidance, we believe an entity can use transaction-level detail, estimates, or a combination of those approaches to compute disclosure amounts. When applying estimates, an entity should:

[4] In addition to the requirement under ASC 220-40 to integrate certain amounts into the tabular format (see Section 2.5), the entity must also apply existing disclosure requirements for all respective applicable guidance under U.S. GAAP.

- Consider all reasonably available information including current data, historical trends, forecasts, and allocations
- Document its estimation approach, assumptions, and relevant internal controls
- Regularly compare estimates to actual outcomes and re-evaluate the estimation methodology as appropriate

Estimating amounts in accordance with the disclosure requirements requires the application of professional judgment based on the facts and circumstances.



EXAMPLE 3-1: ILLUSTRATION OF DISAGGREGATION OF INCOME STATEMENT EXPENSES BY AN ENTITY WITH MANUFACTURING AND SERVICE OPERATIONS

(QUOTED FROM ASC 220-40-55-3 THROUGH 55-12)

ASC 220-40-55-3

This Example illustrates one type of tabular format disclosure that an entity could use to disclose disaggregated expense amounts in accordance with paragraphs 220-40-50-1 through 50-34. This Example also illustrates the disclosure of selling expenses in accordance with paragraphs 220-40-50-35 through 50-36.

ASC 220-40-55-4

For the year ended December 31, 20X4, Entity X, which is a manufacturer with significant service operations, presents the following comparative income statement.

Entity X

Consolidated Income Statement

For the Years Ended December 31, 20X4, 20X3, and 20X2

	20X4	20X3	20X2
Revenue:			
Products	$ 82,144	$ 79,137	$ 75,180
Services	26,132	23,146	21,989
Total revenues	108,276	102,283	97,169
Operating expenses:			
Cost of products sold	63,456	60,898	57,244
Cost of services	10,496	9,568	8,898
Selling, general, and administrative	20,849	18,871	18,116
Total operating expenses	94,801	89,337	84,258
Operating income	13,475	12,946	12,911
Interest expense	4,971	4,213	4,297
Income before income taxes	8,504	8,733	8,614
Income tax expense	1,786	1,834	1,809
Net income	$ 6,718	$ 6,899	$ 6,805

ASC 220-40-55-5

Entity X provides a disclosure that disaggregates the cost of products sold; cost of services; and selling, general, and administrative expense captions into the categories listed in paragraph 220-40-50-6. Those expense captions were identified as relevant expense captions because those captions contain one or more of the expense categories listed in paragraph 220-40-50-6. Even

though Entity X presents other expense captions on the face of its consolidated income statement, such as interest expense and income tax expense, those expense captions do not contain any of the expense categories listed in paragraph 220-40-50-6 (including those described in paragraphs 220-40-50-10 through 50-11); therefore, those expense captions do not need to be disaggregated.

ASC 220-40-55-6

Because cost of products sold contains amounts related to inventory within the scope of Topic 330, Entity X may elect to disclose the amounts under a cost-incurred basis or expense-incurred basis. In this Example, Entity X chooses to disclose the disaggregation of cost of products sold on a cost-incurred basis (that is, the amounts disclosed include costs incurred that were capitalized to inventory during the current reporting period and costs incurred that were directly expensed during the current reporting period) in accordance with paragraph 220-40-50-31(a). Because Entity X discloses the required expense categories using a cost-incurred basis, the entity discloses the changes in inventories caption and the other adjustments and reconciling items caption in accordance with paragraphs 220-40-50-32 through 50-33. In accordance with paragraph 220-40-50-34, Entity X qualitatively describes the nature of amounts included in other adjustments and reconciling items. If Entity X had instead disclosed the required expense categories on an expense-incurred basis (that is, the amounts disclosed comprise expense amounts related to the derecognition of inventory that was previously capitalized in accordance with Topic 330 and any costs incurred that were directly expensed during the current reporting period) in accordance with paragraph 220-40-50-31(b), then the changes in inventories caption and the other adjustments and reconciling items caption would not be necessary in the disaggregation disclosure.

ASC 220-40-55-7

Entity X also recognizes impairment of property, plant, and equipment classified as held and used in selling, general, and administrative expenses and, therefore, includes that impairment as a separate category in the tabular format disclosure in accordance with paragraph 220-40-50-21(c).

ASC 220-40-55-8

Entity X recognizes expenses associated with warranty accruals entirely within cost of products sold and, therefore, includes warranty expense as a separate category in accordance with paragraph 220-40-50-22(k).

ASC 220-40-55-9

Entity X recognizes operating lease costs in both cost of services and selling, general, and administrative expenses. Therefore, in accordance with paragraph 220-40-50-22, Entity X is not required to separately disclose the amounts of cost of services and selling, general, and administrative expenses that are attributable to operating lease cost. Instead, those expenses are included in the amount for other items for each relevant expense caption in accordance with paragraph 220-40-50-30.

ASC 220-40-55-10

Entity X recognizes amounts related to the initial recognition and subsequent measurement of a liability for an environmental obligation in cost of products sold (see Subtopic 410-30 on asset retirement and environmental obligations). In accordance with paragraph 220-40-50-16, Entity X is not required to disaggregate that amount into the expense categories listed in paragraph 220-40-50-6. Instead, that expense is included in the amount for other items in accordance with paragraph 220-40-50-30.

ASC 220-40-55-11

Entity X provides the following disclosure.

Disaggregation of Relevant Expense Captions			
	20X4	*20X3*	*20X2*
Cost of products sold			
Cost of products sold			
Purchases of inventory	*$ 20,213*	*$ 19,199*	*$ 16,319*
Employee compensation	*17,578*	*16,539*	*14,078*
Depreciation	*10,190*	*9,989*	*9,650*
Intangible asset amortization	*3,914*	*4,050*	*3,929*
Warranty expense	*4,394*	*3,952*	*3,894*
Other cost of products sold [(a)]	*7,552*	*7,606*	*7,993*
Changes in inventories	*157*	*(861)*	*843*
Other adjustments and reconciling items [(b)]	*(542)*	*424*	*538*
Total cost of products sold	*$ 63,456*	*$ 60,898*	*$ 57,244*

[(a)] Other cost of products sold consists primarily of amounts paid to carriers for outbound freight services related to contract fulfillment and amounts related to the measurement of a liability for an environmental obligation for the years ended December 31, 20X4, 20X3, and 20X2. Year ended December 31, 20X4, also includes inventory amounts recognized as part of a business combination.

[(b)] Other adjustments and reconciling items consist of reconciling adjustments attributable to differences in the foreign exchange rates used to translate beginning inventory, ending inventory, and costs incurred from various functional currencies into the reporting currency for the years ended December 31, 20X4, 20X3, and 20X2.

Cost of services	*[20X4]*	*[20X3]*	*[20X2]*
Cost of services			
Employee compensation	*$ 6,598*	*$ 5,654*	*$ 4,354*
Depreciation	*763*	*765*	*742*
Intangible asset amortization	*642*	*670*	*650*
Other cost of services[(c)]	*2,493*	*2,479*	*3,152*
Total cost of services	*$ 10,496*	*$ 9,568*	*$ 8,898*

[(c)] Other cost of services consists primarily of operating lease and travel expenses for the years ended December 31, 20X4, 20X3, and 20X2.

Selling, general, and administrative	*[20X4]*	*[20X3]*	*[20X2]*
Selling, general, and administrative (SG&A)			
Employee compensation	*$ 13,242*	*$ 11,379*	*$ 10,764*
Depreciation	*1,454*	*1,755*	*1,737*
Property, plant and equipment impairment	*412*	*—*	*—*
Intangible asset amortization	*523*	*596*	*—*
Other SG&A [(d)]	*5,218*	*5,141*	*5,615*
Total SG&A	*$ 20,849*	*$ 18,871*	*$ 18,116*

[(d)] Other SG&A consists primarily of professional service fees and operating lease expense for the years ended December 31, 20X4, 20X3, and 20X2.

ASC 220-40-55-12

In addition to the tabular format disclosure illustrated in paragraph 220-40-55-11, Entity X also must disclose its selling expenses and how it defines selling expenses in accordance with paragraphs 220-40-50-35 through 50-36.

Selling Expenses

During the years ended December 31, 20X4, 20X3, and 20X2, selling expenses were $13,425, $12,123, and $11,585, respectively. The entity's selling expenses include those expenses related to marketing and promotional activities and client relationship management.



EXAMPLE 3-2: ILLUSTRATION OF DISAGGREGATION OF INCOME STATEMENT EXPENSES BY AN ENTITY WITH SERVICE OPERATIONS

(QUOTED FROM ASC 220-40-55-13 THROUGH 55-19)

ASC 220-40-55-13

This Example illustrates one type of tabular format disclosure that an entity could use to disclose disaggregated expense amounts in accordance with paragraphs 220-40-50-1 through 50-34. This Example also illustrates the disclosure of selling expenses in accordance with paragraphs 220-40-50-35 through 50-36.

ASC 220-40-55-14

For the year ended December 31, 20X4, Entity X, which is a services provider, presents the following comparative income statement.

Entity X

Consolidated Income Statement

For the Years Ended December 31, 20X4, 20X3, and 20X2

	20X4	20X3	20X2
Revenue	$ 737,132	$ 710,146	$ 694,180
Cost of sales (exclusive of depreciation and amortization shown separately below)	140,055	170,435	145,778
Depreciation and amortization related to cost of sales	31,578	26,178	23,628
Selling, general, and administrative expenses	497,962	458,215	471,626
Research and development expenses	57,235	52,174	48,898
Operating income	10,302	3,144	4,250
Interest expense	3,145	2,665	2,297
Income before income taxes	7,157	479	1,953
Income tax expense	1,503	101	410
Net income	$ 5,654	$ 378	$ 1,543

ASC 220-40-55-15

Entity X provides a disclosure that disaggregates the cost of sales; depreciation and amortization; selling, general, and administrative expenses; and research and development expenses captions into the categories listed in paragraph 220-40-50-6. Those expense captions were identified as relevant expense captions because those captions contain one or more of the expense categories listed in paragraph 220-40-50-6. Even though Entity X presents other expense captions on the face of its consolidated income statement, such as interest expense and income tax expense, those expense captions do not contain any of the expense categories listed in paragraph 220-40-50-6 (including those described in paragraphs 220-40-50-10 through 50-11); therefore, those expense captions do not need to be disaggregated.

ASC 220-40-55-16

Entity X also recognizes one-time employee termination benefits in cost of sales; selling, general, and administrative expenses; and research and development expenses and, therefore, includes this amount as a separate category in the tabular format disclosure in accordance with paragraph 220-40-50-21. Paragraph 220-40-50-21(e) requires that an entity disclose the amount of each major type of cost associated with an exit or disposal activity (for example, one-time employee termination benefits) that is recognized in each relevant expense caption in the same tabular format in which the disclosures required by paragraph 220-40-50-6 are provided. Because one-time employee termination benefits are a form of employee compensation, Entity X discloses that its employee compensation category excludes one-time employee termination benefits because one-time employee termination benefits are disclosed as a separate category.

ASC 220-40-55-17

Entity X has a funded research and development cost-sharing arrangement with a strategic partner. Entity X recognizes an expense reimbursement from the strategic partner in research and development expenses and, in accordance with paragraph 220-40-50-26(a), elects to separately disclose the amount of that expense reimbursement. If Entity X had elected to present a relevant expense caption net of an expense reimbursement from another entity, it would have been required to disclose the amount of the expense categories that are included in each relevant expense caption. Additionally, in accordance with paragraph 220-40-50-29, Entity X qualitatively describes the expense categories to which the reimbursement relates.

ASC 220-40-55-18

Entity X provides the following disclosure.

Disaggregation of Relevant Expense Captions

	20X4	20X3	20X2
Cost of sales			
Cost of sales			
Employee compensation (exclusive of one-time employee termination benefits)	$ 86,336	$ 83,903	$ 100,009
One-time employee termination benefits	7,434	39,298	—
Other cost of sales [(a)]	46,285	47,234	45,769
Total cost of sales	$ 140,055	$ 170,435	$ 145,778

(a) Other cost of sales consists primarily of subcontractor costs and travel expenses for the years ended December 31, 20X4, 20X3, and 20X2.

Depreciation and amortization related to cost of sales	*[20X4]*	*[20X3]*	*[20X2]*
Depreciation and amortization related to cost of sales			
Depreciation	*$ 19,126*	*$ 17,984*	*$ 17,893*
Intangible asset amortization	*12,452*	*8,194*	*5,735*
Total depreciation and amortization related to cost of sales	*$ 31,578*	*$ 26,178*	*$ 23,628*

Selling, general, and administrative expenses	*[20X4]*	*[20X3]*	*[20X2]*
Selling, general, and administrative expenses (SG&A)			
Employee compensation (exclusive of one-time employee termination benefits)	*$ 278,859*	*$ 238,272*	*$ 301,841*
One-time employee termination benefits	*19,243*	*60,635*	*-*
Other SG&A [(b)]	*199,860*	*159,308*	*169,785*
Total SG&A	*$ 497,962*	*$ 458,215*	*$ 471,626*

[(b)] Other SG&A consists primarily of professional services fees and the costs paid to third parties for printing, publications, and advertising for the years ended December 31, 20X4, 20X3, and 20X2.

Research and development expenses	***[20X4]***	***[20X3]***	***[20X2]***
Research and development expenses (R&D)			
Employee compensation (exclusive of one-time employee termination benefits)	*$ 46,242*	*$ 41,379*	*$ 40,764*
One-time employee termination benefits	*1,454*	*1,855*	*-*
Other R&D [(c)]	*17,836*	*16,845*	*15,890*
Cost reimbursements [(d)]	*(8,297)*	*(7,905)*	*(7,756)*
Total R&D	*$ 57,235*	*$ 52,174*	*$ 48,898*

[(c)] Other R&D consists primarily of payments to third parties for professional services and licenses of intellectual properties for the years ended December 31, 20X4, 20X3, and 20X2.

[(d)] Cost reimbursements consist of payments from a strategic partner for employee compensation and materials costs related to R&D incurred as part of a funded research and development arrangement for the years ended December 31, 20X4, 20X3, and 20X2.

ASC 220-40-55-19

In addition to the tabular format disclosure illustrated in paragraph 220-40-55-18, Entity X also must disclose its selling expenses and how it defines selling expenses in accordance with paragraphs 220-40-50-35 through 50-36.

Selling Expenses

During the years ended December 31, 20X4, 20X3, and 20X2, selling expenses were $224,536, $223,493, and $231,892, respectively. The entity's selling expenses include those expenses related to advertising and certain customer acquisition-related costs.



EXAMPLE 3-3: ILLUSTRATION OF DISAGGREGATION OF INCOME STATEMENT EXPENSES BY A BANK

(QUOTED FROM ASC 220-40-55-20 THROUGH 55-25)

ASC 220-40-55-20

This Example illustrates one type of tabular format disclosure that an entity could use to disclose disaggregated expense amounts in accordance with paragraphs 220-40-50-1 through 50-34. This Example also illustrates the disclosure of selling expenses in accordance with paragraphs 220-40-50-35 through 50-36.

ASC 220-40-55-21

For the year ended December 31, 20X4, Entity X, which is a bank, presents the following comparative income statement.

Entity X *Consolidated Income Statement*			
	20X4	***20X3***	***20X2***
Interest income			
Loans	$ 2,795,052	$ 2,142,873	$ 2,072,997
Investment securities	628,887	442,550	465,842
Other	209,629	116,461	79,193
Total interest income	3,633,568	2,701,884	2,618,032
Interest expense			
Deposits	302,797	30,280	151,399
Borrowed funds	279,505	83,852	167,703
Total interest expense	582,302	114,132	319,102
Net interest income	3,051,266	2,587,752	2,298,930
Provision for (recapture of) credit losses	116,461	(186,337)	372,674
Net interest income after provision for (recapture of) credit losses	2,934,805	2,774,089	1,926,256
Noninterest income			
Service charges on deposit accounts	201,702	171,062	151,969
Other service charges and fees	282,383	239,487	212,757
Total noninterest income	484,085	410,549	364,726
Noninterest expense			
Salaries and employee benefits	1,464,608	1,176,183	1,365,443
Occupancy and depreciation	376,587	279,875	349,679
Data processing	166,111	146,308	161,046
Advertising and marketing	56,876	30,555	28,192
Professional fees	73,230	61,459	74,473
Other	30,513	21,399	24,804
Total noninterest expense	2,167,925	1,715,779	2,003,637
Income before income taxes	1,250,965	1,468,859	287,345
Income tax expense	262,703	308,460	60,342
Net income	$ 988,262	$ 1,160,399	$ 227,003

ASC 220-40-55-22

Entity X provides a disclosure that disaggregates the occupancy and depreciation expense and other expense captions into the categories listed in paragraph 220-40-50-6. Those expense captions were identified as relevant expense captions because those captions contain one or more of the expense categories listed in paragraph 220-40-50-6. In this Example, even though Entity X also presents separate expense captions on the face of its consolidated income statement for interest expense, provision for (recapture of) credit losses, data processing, advertising and marketing, professional fees, and income tax expense, those expense captions do not contain any of the expense categories listed in paragraph 220-40-50-6 (including those described in paragraphs 220-40-50-10 through 50-11); therefore, those expense captions do not need to be further disaggregated. Entity X applies the practical expedient for employee compensation described in paragraph 220-40-50-20 and elects to not repeat the amount presented on the face of the income statement in the notes to financial statements.

ASC 220-40-55-23

Entity X recognizes operating lease cost entirely within occupancy and depreciation expense and, therefore, includes operating lease cost as a separate category in accordance with paragraph 220-40-50-22(p).

ASC 220-40-55-24

Entity X provides the following disclosure.

Disaggregation Of Relevant Expense Captions			
	20X4	***20X3***	***20X2***
Occupancy and depreciation expense			
Occupancy and depreciation expense			
Depreciation	*$ 164,232*	*$ 146,403*	*$ 145,907*
Operating lease expense	*152,445*	*103,239*	*149,842*
Other occupancy expenses [(a)]	*59,910*	*30,233*	*53,930*
Total occupancy and depreciation expense	*$ 376,587*	*$ 279,875*	*$ 349,679*

[(a)] Other occupancy expenses consist primarily of repair and maintenance expense for the years ended December 31, 20X4, 20X3, and 20X2.

Other	***[20X4]***	***[20X3]***	***[20X2]***
Other			
Intangible asset amortization	*$ 13,139*	*$ 10,980*	*$ 10,068*
Other [(b)]	*17,374*	*10,419*	*14,736*
Total other	*$ 30,513*	*$ 21,399*	*$ 24,804*

[(b)] Other consists primarily of regulatory licensing fees and charitable contributions for the years ended December 31, 20X4, 20X3, and 20X2.

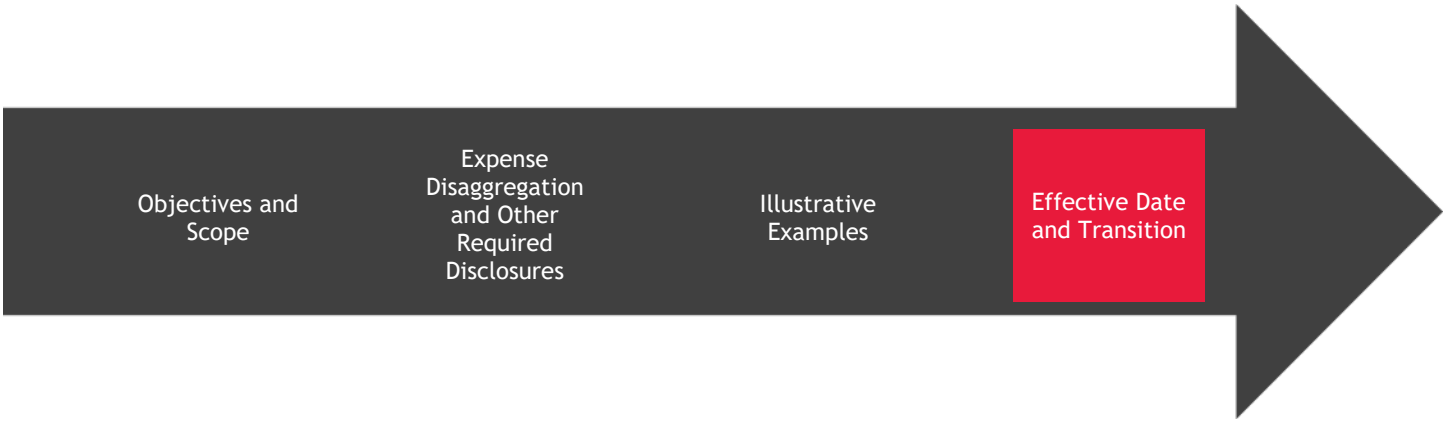
ASC 220-40-55-25

In addition to the tabular format disclosure illustrated in paragraph 220-40-55-24, Entity X also must disclose its selling expenses and how it defines selling expenses in accordance with paragraphs 220-40-50-35 through 50-36.

Selling Expenses

During the years ended December 31, 20X4, 20X3, and 20X2, the entity defined selling expenses to be the same as its advertising and marketing expenses, which are presented on the face of its consolidated income statement. The entity's advertising and marketing expenses include costs incurred for advertising, market research, and business development.

Chapter 4: Effective Date and Transition



4.1 OVERVIEW

All public business entities (PBEs) must apply ASC 220-40 in accordance with the transition guidance in ASUs 2024-03 and 2025-01. This chapter organizes the related transition guidance into the following categories:

- Effective date (see Section 4.2)
- Transition approaches (see Section 4.3)

4.2 EFFECTIVE DATE

FASB REFERENCES

ASC 220-40-65-1(a)

All PBEs must apply ASC 220-40 for annual reporting periods beginning after December 15, 2026, and interim reporting periods within annual reporting periods beginning after December 15, 2027. For example, a calendar-year PBE must apply the standard beginning January 1, 2027 for the year ended December 31, 2027, and interim periods thereafter (beginning the quarter ending March 31, 2028). Early adoption is permitted.

SMALLER REPORTING COMPANIES AND EMERGING GROWTH COMPANIES

The effective date for ASC 220-40 applies to all PBEs, including smaller reporting companies (SRCs) and nonissuers that are required to file or furnish financial statements with or to the SEC (such as broker-dealers).

Furthermore, there is no separate effective date for private companies. Therefore, even if an emerging growth company (EGC) has elected to use an extended transition period for new or revised accounting standards, it cannot defer adoption of ASC 220-40.

We encourage PBEs, including SRCs and EGCs, to allow sufficient time to familiarize themselves with the new guidance and design and implement the necessary internal controls over financial reporting.

BDO INSIGHT 4-1: ENTITIES CAN EARLY ADOPT DURING ANY PERIOD

An entity can elect to early adopt ASC 220-40, including in an interim reporting period before the first required annual reporting period. Although early adoption is permitted in any quarter, adopting in the first quarter of the fiscal year is generally considered the best practice. Adopting in later quarters may create operational complexity and reduce comparability within the reporting period.

As of the adoption date, an entity that early adopts ASC 220-40 must comply with all disclosure requirements. While comparative information is not required in the initial period of adoption for entities adopting prospectively (see Section 4.3), entities must establish processes and implement controls to support future comparative disclosures. In practice, entities applying the prospective transition approach may still prepare comparative information internally to support investor communications even though such information is not required.

4.3 TRANSITION APPROACHES

FASB REFERENCES

ASC 220-40-65-1(b) through 65-1(c)

A PBE can adopt ASC 220-40 either prospectively or retrospectively. The table below summarizes the impact of each transition method.

PROSPECTIVE	RETROSPECTIVE
▶ Prepare ASC 220-40 disclosures only for the period of adoption. ▶ Disclosures for other periods presented, including interim periods within the period of adoption, are not required.	▶ Prepare ASC 220-40 disclosures for any or all prior periods presented (for example, an entity providing the ASC 220-40 disclosures in its 2027 Form 10-K for the first time provides the disclosures for its 2026 annual reporting period but not 2025). ▶ Provide all ASC 220-40 disclosures for prior periods to which the disclosure requirements are applied.

The flexibility to apply ASC 220-40 to "any or all" prior periods only applies in the period of adoption. Once an entity has applied ASC 220-40 disclosures to a period, that period becomes a comparative period in future financial statements and generally must continue to be presented. For example, if an entity elects to provide ASC 220-40 disclosures for 2027 and 2026 upon adoption, the 2026 disclosures would be presented again as comparative information when the entity reports 2028 results.

BDO INSIGHT 4-2: ENTITIES SHOULD PREPARE COMPARATIVE INFORMATION INTERNALLY

While comparative information is not required in the initial period of adoption, entities must nevertheless establish processes and implement controls to support future comparative disclosures. In practice, entities applying the prospective transition approach might still prepare comparative information internally to support investor communications, even though such information is not required.

Preparing comparative information requires the application of professional judgment based on the facts and circumstances.

Appendix A: Other BDO Publications



BDO's Professional Practice — Accounting Group has issued the following Blueprints, which provide detailed accounting guidance, interpretive insights, and practical examples on complex areas of U.S. GAAP:

- Accounting for Software Costs
- Statement of Cash Flows Under ASC 230
- Segment Reporting Under ASC 280
- Equity Method Investments Under ASC 323
- Impairments under ASC 350 and ASC 360
- Revenue Recognition Under ASC 606
- Share-based Payments Under ASC 718
- Business Combinations Under ASC 805
- Control and Consolidation Under ASC 810
- Accounting for Leases Under ASC 842
- Issuer's Accounting for Complex Financial Instruments

BDO's Professional Practice — SEC Services Group has issued the following Blueprints to help SEC registrants apply the SEC's rules and regulations related to financial reporting:

- Guide to Going Public

Series Overview: Building Knowledge

In addition to Blueprints, BDO's Professional Practice has issued a suite of publications related to U.S. GAAP and SEC rules and regulations:

- Bulletins: short, timely communications delivering essential news, alerts, and developments in accounting and SEC reporting
- Snapshots: summaries of SEC rules and regulations
- SEC Reporting Insights, updated annually
- Conference Highlights: Current SEC & PCAOB Developments, updated annually
- Effective Date Reminders, updated annually
- Industry Supplements
- Other publications on new accounting standards and SEC rules and regulations.

For more on IFRS, visit BDO's IFRS and Corporate Reporting site.

Find our latest accounting and reporting publications on BDO's Accounting, Reporting and Compliance Hub (ARCH) at arch.bdo.com



Contacts

JENNIFER KIMMEL
Professional Practice Principal — Accounting
203-905-6284 / jkimmel@bdo.com

MEGHAN DEPP
Professional Practice Principal — SEC Services
248-688-3368/ mdepp@bdo.com

ANGELA NEWELL
Deputy Chief Accountant
214-689-5669 / ajnewell@bdo.com

ADAM BROWN
Chief Accountant
214-665-0673 / abrown@bdo.com

FASB publications excerpted in this publication were reprinted with permission. Copyright 2026 by Financial Accounting Foundation, Norwalk, Connecticut.

At BDO, our purpose is to be the people you count on to grow with confidence and achieve what matters most. Our professionals provide assurance, tax and advisory services for a diverse range of clients across the U.S. and in over 160 countries through our global organization. We are proud to be an ESOP company, inspiring an ownership mindset that enables our collective success.

BDO is the brand name for the BDO network and for each of the BDO Member Firms. BDO USA, P.C., a Virginia professional corporation, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. For more information, please visit: www.bdo.com.

© 2026 BDO USA, P.C. All rights reserved.