IFRS Accounting

Staff paper

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IFRS® Interpretations Committee meeting

Date	**November 2022**
Project	**Potential annual improvements—IAS 7—terminology update**
Topic	**Initial consideration**
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Introduction

1. We have been informed about a potential lack of clarity in paragraph 37 of IAS 7 *Statement of Cash Flows*, which arises from the continued use of a term that is no longer defined in IFRS Accounting Standards.

2. This paper:

   (a) provides the Interpretations Committee (Committee) with a summary of the matter;

   (b) presents our research and analysis; and

   (c) asks the Committee whether it agrees with our preliminary views to include a proposed amendment to paragraph 37 of IAS 7 in the next *Annual Improvements to IFRS Accounting Standards Cycle* (annual improvements).

Structure of this paper

3. This paper includes:

   (a) background information (paragraphs 4–9);

   (b) staff analysis and preliminary views (paragraphs 10–16);

   (c) question for the Committee; and

   (d) Appendix A—recommended proposed amendment to paragraph 37 of IAS 7.

Background information

4. Paragraphs 37–38 of IAS 7 set out requirements for an entity reporting cash flows in respect of its investment in an associate, a joint venture or a subsidiary. Paragraph 37 of IAS 7 includes a reference to ‘cost method’. The paragraph states [emphasis added]:

> When accounting for an investment in an associate, a joint venture or a subsidiary accounted for by the use of the equity or **cost method**, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example to dividends and cash advances.

5. IFRS Accounting Standards previously defined the term ‘cost method’ in paragraph 4 of IAS 27 *Separate Financial Statements* as:

> a method of accounting for an investment whereby the investment is recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distributions from retained earnings of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

6. In May 2008, the International Accounting Standards Board (IASB) issued *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, which amended IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27. As a result of this amendment, the definition of ‘cost method’ was deleted from paragraph 4 of IAS 27.

7. Paragraphs BC14–BC20 of the Basis for Conclusions on IAS 27 explain the IASB’s rationale for deleting the definition of ‘cost method’. In particular, paragraph BC17 states:

> In considering the responses to that exposure draft, the Board observed that the principle underpinning the cost method is that a return of an investment should be deducted from the carrying amount of the investment. However, the wording in the previous version of IAS 27 created a problem in some jurisdictions because it made specific reference to retained earnings as the means of making that assessment. The Board determined that the best way to resolve this issue was to delete the definition of the cost method.

8. Because no consequential amendment[1] was made to paragraph 37 of IAS 7 in the light of this deletion, that paragraph continues to include a reference to 'cost method'—a term that is no longer defined in IFRS Accounting Standards.

Question raised

9. The question raised is whether the term 'cost method' used in paragraph 37 of IAS 7 should be updated because it is no longer defined in IFRS Accounting Standards.

Staff analysis and preliminary views

10. We agree there is a need to update paragraph 37 of IAS 7. We think the current reference to 'cost method' in paragraph 37 results from an oversight when IAS 27 was amended; the reference to 'cost method' would normally have been updated through a consequential amendment.

11. In our view, this matter can be efficiently resolved by replacing the term 'cost method' in paragraph 37 of IAS 7 with the term 'at cost' (see Appendix A to this paper). We note that the previous definition of 'cost method', as set out in paragraph 5 of this paper, said it is 'a method of accounting for an investment whereby the investment is recognised *at cost*' [emphasis added]. As stated in paragraph BC17 of IAS 27—reproduced in paragraph 7 of this paper—the IASB decided to delete the definition of cost method because of its reference to retained earnings. Paragraph 37 of IAS 7 does not refer to retained earnings; it states 'an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances'. Therefore, in our view, there are no further amendments needed to paragraph 37 other than to state 'at cost' rather than 'cost method'.

12. There are other IFRS Accounting Standards that use the words 'cost method'. In particular:

    (a) paragraphs B8–B9 of IFRS 13 *Fair Value Measurement* include a reference to 'cost approach' (or 'current replacement cost method'), which is one of the valuation techniques that may be used in measuring fair value; and

    (b) paragraph 21 of IAS 2 *Inventories* includes a reference to 'standard cost method', which is one of the methods that may be used in measuring the cost of inventories.

13. However, paragraph 37 of IAS 7 is the only remaining Accounting Standard that we have found in which 'cost method' is referred to in the context of accounting for an investment in an associate, a joint venture or a subsidiary. Therefore, we think no other amendments to IFRS Accounting Standards are necessary in the light of the previous deletion of the definition of 'cost method' from IAS 27.

[1] Paragraph 6.31 of the IFRS Foundation's *Due Process Handbook* states that '[w]hen a new IFRS Standard, or amendment to a Standard, is issued, it is also accompanied by amendments to other Standards that are a consequence of the new requirements—these are called 'consequential amendments'.'

Does this matter meet the annual improvements criteria?

14. Paragraphs 6.10–6.13 of the *Due Process Handbook* include the criteria for annual improvements. To meet these criteria, the proposed solution would need to be limited to:

    (a) clarifying the wording in an Accounting Standard, which involves either replacing unclear wording in existing Accounting Standards or providing requirements where an absence of requirements is causing concern; or

    (b) correcting relatively minor unintended consequences, oversights or conflicts between existing requirements.

15. In our view, our proposed solution to amend paragraph 37 of IAS 7 (see Appendix A to this paper) meets these criteria. As we explained earlier, replacing the term 'cost method' with 'at cost' would efficiently resolve the matter. Such an amendment would maintain consistency with the principles and requirements in IAS 7 and IAS 27 and would not propose a new (or change an existing) principle or requirement.

Summary of staff preliminary views

16. Based on our analysis in paragraphs 10–15, our preliminary views are to:

    (a) propose that the IASB amend paragraph 37 of IAS 7 to replace the term 'cost method' with 'at cost' (see Appendix A to this paper); and

    (b) include this proposed amendment in the next annual improvements cycle.

Question for the Committee

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Do Committee members agree with our preliminary views as summarised in paragraph 16 of this paper? If 'no', do you have any other suggestions?

Appendix A—recommended proposed amendment to paragraph 37 of IAS 7

A1. Our proposed amendment to paragraph 37 of IAS 7 would replace the term 'cost method' with 'at cost'. New text is underlined and deleted text is struck through.

37	When accounting for an investment in an associate, a joint venture or a subsidiary accounted for by use of the equity <u>method</u> or <u>at</u> cost ~~method~~, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example to dividends and advances.