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Project **Annual Improvements—2010-2012 cycle**

Topic **IAS 7 *Statement of Cash Flows*—classification of interest paid that is capitalised as part of the cost of an asset**

## Purpose of this paper

1. Paper 7F presented at the September 2011 meeting, asked the Board to analyse a request to clarify the classification in the statement of cash flows of interest paid that is capitalised into the cost of property, plant and equipment. The Committee had discussed this issue at the May 2011 meeting (refer to Agenda paper 6) and made a recommendation to the Board to propose an improvement through the annual improvements project to paragraphs 16(a) and 33 and by adding paragraph 33A to IAS 7 *Statement of Cash Flows*.

2. At the September 2011 meeting, the Board agreed with the Committee's recommendation to include the proposed amendments in the next annual improvements cycle (2010-2012).

3. Paper 7F referred to the criteria assessment made by the Committee in Agenda Paper 6 but did not include these criteria in paper 7F for the Board. Consequently the objective of this paper is to include the Committee's criteria assessment and ask the Board whether it agrees with it.

4. For ease of reference Appendix A of this paper includes the proposed amendment to IAS 7.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB Update. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

5. This criteria assessment is presented below:

***Assessment against the new annual improvements criteria***

6. We have assessed the proposed amendment to paragraphs 16(a) and 33 of IAS 7 and the addition of paragraph 33A to IAS 7 against the enhanced annual improvements criteria, which are reproduced in full below:

In planning whether an issue should be addressed by amending IFRSs within the annual improvements project, the IASB assesses the issue against the following criteria. All criteria (a)–(d) must be met to qualify for inclusion in annual improvements.

(a) The proposed amendment has one or both of the following characteristics:

(i) clarifying–the proposed amendment would improve IFRSs by:

- clarifying unclear wording in existing IFRSs, or
- providing guidance where an absence of guidance is causing concern.

A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle.

(ii) correcting–the proposed amendment would improve IFRSs by:

- resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or.
- addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs.

A correcting amendment does not propose a new principle or a change to an existing principle.

*[Staff analysis—this criterion is satisfied. To avoid inconsistent guidance, there is a need for clarification of the requirements in paragraphs 16(a) and 33 regarding the classification of interest paid that is capitalised as part of the cost of an asset]*

(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.

*[Staff analysis—this criterion is satisfied. The issue is sufficiently narrow to ensure that the proposed change has been considered sufficiently and identified.]*

(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach a conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.

*[Staff analysis—this criterion is satisfied. We think that the Committee will be able to address these issues on a timely basis and we think that the Board should be in a position to also reach a conclusion on a timely basis. The issue can be sufficiently tackled by a clarification to the current wording of paragraphs 16(a) and 33 in IAS 7, and proposed adding paragraph 33A to clarify that the classification of payments of interest that are capitalised shall follow the classification of the underlying asset to which those payments were capitalised. This amendment provides increased clarity where diversity currently exists, while not significantly affecting the primary accounting treatment that exists in practice for this issue.]*

(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.

*[Staff analysis—this criterion is satisfied. There is no current IASB project on IAS 7 and none is planned for the near future.]*

## Question to the Board

| **Question 1—criteria assessment for proposed changes to IAS 7** |
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| Does the Board agree with the criteria assessment presented above? |

# Appendix A – Proposed changes to IAS 7

A1. The staff proposes amendments to paragraphs 16(a) and 33 are presented below. The staff also proposes adding paragraph 33A.

### Amendment to IAS 7 *Statement of Cash Flows*

Paragraphs 16(a) and 33 are amended (new text is underlined and deleted text is struck through). Paragraph 33A is added. Paragraph 32 is not proposed for amendment but is included here for ease of reference.

### Investing activities

16 The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire property, plant and equipment, intangibles and other long-term assets, as well as payments of interest capitalised as part of the cost of those assets. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment.

(b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;

(c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);

(f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

## Interest and dividends

32 The total amount of interest paid during a period is disclosed in the statement of cash flows whether it has been recognised as an expense in profit or loss or capitalised in accordance with IAS 23 *Borrowing Costs.*

33 Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of profit or loss. Alternatively, interest paid (except for payments of interest that are capitalised, which shall be classified in accordance with paragraph 33A), and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are either costs of obtaining financial resources or returns on investments.

33A Payments of interest that are capitalised in accordance with IAS 23 shall be classified in conformity with the classification of the underlying asset to which those payments were capitalised. For example, payments of interest that are capitalised as part of the cost of property, plant and equipment shall be classified as part of an entity's investing activities; and payments of interest that are capitalised as part of the cost of inventories shall be classified as part of an entity's operating activities.

## Basis for Conclusions on proposed amendments to IAS 7 *Statement of Cash Flows*

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| This Basis for Conclusions accompanies, but is not part of, the proposed amendments. |

## Classification of interest paid that is capitalised

BC1 The Board received a request to clarify the classification in the cash flow statement of interest paid that is capitalised into the cost of property, plant and equipment. Paragraph 16 was interpreted as requiring interest paid that has been capitalised to be classified as an investing cash flow. However, the Board was informed that this seemed to be inconsistent with paragraphs 32 and 33 which required interest paid to be classified only as an operating or a financing cash flow. To eliminate a conflict the Board proposes a modification to paragraphs

16(a) and 33 of IAS 7 and proposes adding paragraph 33A to clarify that the classification of payments of interest that are capitalised shall follow the classification of the underlying asset to which those payments were capitalised.