
IASB[®] meeting

Date	February 2023
Project	Cost method (IAS 7)
Topic	Potential annual improvement
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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. The IFRS Interpretations Committee (Committee) discussed this matter at its meeting in November 2022—see [Agenda Paper 3D](#) for that meeting.
3. The objective of this paper is:
 - (a) to provide the International Accounting Standards Board (IASB) with background on the matter and staff analysis, including consideration of the Committee's discussion; and
 - (b) to ask the IASB whether it agrees with our recommendation to include a proposed amendment to paragraph 37 of IAS 7 in its next *Annual Improvements to IFRS Accounting Standards Cycle* (annual improvements).

Structure of this paper

4. This paper includes:
 - (a) Background information;
 - (b) Staff analysis, including consideration of the Committee's discussion and transition requirements;
 - (c) Staff recommendations and question for the IASB; and
 - (d) Appendix A—recommended proposed amendment to paragraph 37 of IAS 7.

Summary of staff recommendations

5. We recommend that the IASB:
 - (a) propose an amendment to paragraph 37 of IAS 7 to replace the term 'cost method' with 'at cost';
 - (b) develop no specific transition requirements for this proposed amendment; and
 - (c) include this proposed amendment in its next annual improvements cycle.

Background information

6. Paragraphs 37 and 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 advances.

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7. 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.

8. In May 2008, the 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.

9. 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.

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10. Because no consequential amendment¹ 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

11. 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

12. 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.
13. 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 agenda paper). We note that the previous definition of ‘cost method’, as set out in paragraph 7 of this agenda 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 9 of this agenda 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’.

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’.’

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14. Paragraph 37 of IAS 7 is the only remaining instance in IFRS Accounting Standards 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. There are other instances in IFRS Accounting Standards where the words ‘cost method’ are used, but these are in different contexts and with a different meaning than was used in IAS 27. 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.
15. 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.

Does this matter meet the annual improvements criteria?

16. 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.
17. In our view, our proposed solution to amend paragraph 37 of IAS 7 (see Appendix A to this agenda 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.

The Committee's discussion

18. The Committee discussed this potential annual improvement at its November 2022 meeting. All Committee members agreed, or did not disagree, with our analysis and preliminary views.
19. One Committee member raised a question related to paragraph 10 of IAS 27 which states [emphasis added]:

When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:

- (a) at cost;
- (b) **in accordance with IFRS 9**; or
- (c) using the equity method as described in IAS 28.

The entity shall apply the same accounting for each category of investments. Investments accounted for at cost or using the equity method shall be accounted for in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* when they are classified as held for sale or for distribution (or included in a disposal group that is classified as held for sale or for distribution). The measurement of investments accounted for in accordance with IFRS 9 is not changed in such circumstances.

20. The Committee member asked about the interaction between paragraph 10 of IAS 27 and paragraph 37 of IAS 7 and, in particular, whether the phrase ‘in accordance with IFRS 9’ should also be added to paragraph 37 of IAS 7.

Staff analysis of the Committee input

21. The Basis for Conclusions on IAS 7 does not include an explanation of the reasoning behind paragraph 37 of IAS 7². We do not have reason to think that the IASB intended to include an investment accounted for in accordance with IFRS 9 in the scope of paragraph 37 of IAS 7. Doing so would effectively introduce a new requirement and, consequently, not meet the criteria for annual improvements as set out in the *Due Process Handbook*—in particular, paragraphs 6.12–6.13 state that annual improvements do ‘not propose a new principle or change an existing principle’. We therefore recommend not to add the phrase ‘in accordance with IFRS 9’ to paragraph 37 of IAS 7.

Transition requirements

22. Our proposed amendment to paragraph 37 of IAS 7 to replace the term ‘cost method’ with ‘at cost’ would improve clarity in that paragraph, without changing or adding new requirements. We do not expect any change in practice arising from this proposed amendment. Therefore, in our view, there is no need to develop any specific transition requirements.
23. In the absence of any specific transition requirements, an entity would apply the proposed amendment retrospectively in accordance with paragraph 19(b) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Staff recommendations and question for the IASB

24. Based on our analysis in paragraphs 6–21 of this agenda paper, we recommend the IASB, as part of its next annual improvements cycle, amend paragraph 37 of IAS 7 to replace the term ‘cost method’ with ‘at cost’ (see Appendix A to this agenda paper).

² Paragraph BC2 of the Basis for Conclusions on IAS 7 states that IAS 7 was developed by the International Accounting Standards Committee (the predecessor to the IASB) and was not accompanied by a Basis for Conclusions.

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25. Based on our analysis in paragraphs 22–23 of this agenda paper, we recommend the IASB develop no specific transition requirements.

Question for the IASB

Does the IASB agree with our recommendations:

- a. to propose an amendment to paragraph 37 of IAS 7 to replace the term ‘cost method’ with ‘at cost’;
- b. to develop no specific transition requirements for this proposed amendment; and
- c. to include this proposed amendment in its next annual improvements cycle?

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 cost</u> 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.
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