STAFF PAPER

June 2014

ASAF Meeting

Project	**Conceptual Framework**		
Paper topic	Business model		
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Purpose

1. The purpose of this session is to seek input from ASAF members on whether the notion of a business model (or similar notions) should play a role in financial reporting, and how can it help in standard-setting. To meet this objective, we seek input on the following points:

   (a) What function(s) would such a notion have in the *Conceptual Framework*? How would you describe or define this notion? Would this be a single notion, or would different notions apply for different parts of the *Conceptual Framework*? (See paragraphs 16-31, and questions 1 and 2.)

   (b) What label should be used for the notion(s) identified above? For ease of discussion, we will use the label 'business model' in this paper. (See paragraphs 32-34 and question 3.)

2. For this paper, we have focused the discussion on how a business model notion might help the IASB in setting standards. We are not ignoring the fact that other parties also use the *Conceptual Framework*.

Background

How is business model used in existing Standards?

3. The IASB first used the term 'business model' in IFRS 9 *Financial Instruments*, which stated that classification and measurement of financial assets depend on an entity's business model for managing those assets.

4. IFRS 9 *Financial Instruments* does not define an entity's business model but notes the following:

   (a) the entity's key management personnel (as defined in IAS 24 *Related Party Disclosures*) are responsible for determining the objective of the business model;

   (b) an entity's business model is not a choice but is instead a matter of fact that can be observed by the way an entity is managed and information is provided to its management;

   (c) a single entity may have more than one business model for managing its financial instruments; and

   (d) a business model is different from 'management's intentions', which can relate to a single financial instrument.

5. At its November 2013 meeting, the IASB tentatively agreed to clarify that the business model, when relating to how financial assets are classified, is based on the cash flow realisation notion which refers to actual management of financial assets in order to generate cash flows and create value for the entity.

6. In IFRS 10 *Consolidated Financial Statements*, the IASB required investment entities not to consolidate some of their subsidiaries (see paragraph BC226 of IFRS 10 *Consolidated Financial Statements*) because investment entities have a unique business model that makes reporting subsidiaries at fair value more appropriate than consolidation.

7. Although other Standards do not explicitly refer to a business model, the way in which an entity uses its assets has previously been used in IFRSs, particularly in classifying and measuring different types of non-financial assets:

(a) inventories are assets that are held for sale in the ordinary course of business; in the process of production for such sales; or in the form of materials or supplies to be consumed in the production process or in the rendering of services (see IAS 2 *Inventories*).

(b) inventories held by commodity broker-traders are measured differently from other inventories because they are acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin (see paragraph 5 of IAS 2).

(c) investment properties are held to earn rentals or for capital appreciation or both, rather than for:

    (i) use in the production or supply of goods or services or for administrative purposes; or

    (ii) sale in the ordinary course of business (see IAS 40 *Investment Property*).

(d) property, plant and equipment are held for use in the production or supply of goods or services or for administrative purposes (see IAS 16 *Property, Plant and Equipment*).

(e) non-current assets that will no longer be used by the entity (assets that are held for sale or are discontinued) are measured differently from other non-current assets (see IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*).

Discussion Paper

8. In the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*, the IASB did not define a business model notion. Instead, the Discussion Paper:

(a) expressed the view that 'financial statements can be made more relevant if the IASB considers, when it develops or revises particular Standards, how an entity conducts its business activities'.

(b) noted that the following sections of the Discussion Paper considered how an entity conducts its business activities:

(i) Section 6–Measurement: the IASB should consider how an asset contributes to future cash flows and how a liability will be settled or fulfilled when deciding on an appropriate measurement method.

(ii) Section 7–Presentation and disclosure: in determining the level of aggregation or disaggregation in the primary financial statements, the IASB or an entity will need to consider how the item is used in the entity's business.

(iii) Section 8–Presentation in the statement(s) of profit or loss and other comprehensive income: in deciding whether to present different measurements in profit or loss and the statement of financial position (ie a bridging item), the IASB should consider (among other things) how the entity will use that item in its business.

9. The Discussion Paper stated that the IASB has not identified any other significant implications of the business model notion for the *Conceptual Framework*.

Overview of comments received

10. Many of the respondents who supported the IASB's preliminary views thought that the IASB should define, or provide further clarification on, the business model concept in the *Conceptual Framework*. Otherwise different interpretations of the business model notion could arise in practice.

11. However, respondents had different views on what is a business model, and this led to mixed views on whether the business model should be considered fundamental to financial reporting or should play a more limited role.

12. Most respondents agreed that the IASB should consider how an entity conducts its business activities when determining issues relating to measurement, presentation and disclosure and the distinction between profit or loss and other comprehensive income (OCI). They typically described this as examples of applying the business model in standard-setting.

13. In addition, some preparers thought that consideration of the business model is also relevant in:

(a) determining the unit of account;

(b) considering the distinction between liabilities and equity (this view was expressed by the many co-operative entities that responded to the Discussion Paper); and

(c) deciding whether to recognise an asset or liability.

14. Some user respondents (mainly user groups) commented on the role of business model in standard-setting and had mixed views:

(a) A user group that identified themselves as long-term investors placed emphasis on the use of the business model in developing Standards.

(b) A few users thought that financial reporting should reflect the economic substance of a company's activities and thought that the business model notion would help achieve this. However, they cautioned the IASB against undermining comparability (for example, by allowing accounting policy choices for transactions that are identical in substance and without appropriate disclosures).

(c) Other users disagreed with emphasising the business model. They suggested that referring to the business model is a pathway to the introduction of management bias. They advocated a more objective basis to achieve a faithful representation of assets and liabilities. They expressed the view that neither management intent nor business model changes the values of assets or liabilities. The outcome of the business model should be clear through the use of objective measures of assets and liabilities.

15. Appendix A contains extracts from comment letters submitted by ASAF members. The summary of comments received on the business model is available on the *Conceptual Framework* website[1].

How could the notion business model apply in standard-setting?

16. We think how the business model (or the notion underpinning a business model) is described and how it applies in standard-setting are ***related***. We think that

[1] http://www.ifrs.org/Current-Projects/IASB-Projects/Conceptual-Framework/Pages/Discussion-and-papers-stage-4.aspx

respondents had a variety of applications in mind for standard-setting, and this explains they had different views on what a business model is.

Describing the business model

17. We reviewed various literature[2] and noted that, consistent with the response to the Discussion Paper, there is a variety of descriptions of the business model notion. In summary, the different articulations of business model are as follows:

    (a) How the entity uses the groups of assets/liabilities to generate cash flows.

    (b) How an entity generates cash flows.

    (c) The areas in which the entity operates in eg manufacturing, e-commerce.

    (d) How the management intends to use an individual asset or liability to generate cash flows.

    (e) A business model considers all types of inputs, ie culture, procedures and strategies to support the objective of the entity.

18. Some respondents suggested specific business models that the IASB should focus on. For example:

    (a) Some suggested that there is a long-term investment business model with characteristics different from the characteristics of business models that focus on a shorter time horizon.

    (b) Some suggested that there is a business model that involves paying particular attention to interactions between the entity's liabilities and its assets (asset-liability management models).

    (c) Roger Marshall and Andrew Lennard in their paper *The reporting of income and expense and the choice of measurement bases* (see Agenda paper 6 for this meeting) suggest that there are two common types of businesses:

[2] Our review included academic and business literature, guidance from different regulators and work done by accounting bodies and standard-setters.

(i) Value added businesses: Businesses that obtain inputs from suppliers and employees, and usually after some kind of process, use those inputs to provide goods and services to customers from which revenue is obtained. Examples include manufacturing and providers of services types of businesses.

(ii) Price change businesses: Other businesses that involve the acquisition of assets (and sometimes liabilities) in order to benefit from gains resulting from changes in their value. Examples of such businesses are commodity dealers and investment funds.

19. However, other respondents thought that there are many types of business models. Consequently, they did not support the idea that the IASB should consider the business model notion in standard-setting because the IASB may not be able to develop Standards that would adequately represent the many different business models.

20. In addition, EFRAG has produced a research paper that discusses the business model. Appendix B contains a summary of that research paper.

What functions would a business model notion serve?

21. As noted above, the Discussion Paper suggested that the IASB may consider how an entity conducts its business activities when deciding on measurement, presentation and disclosure and distinguishing between profit or loss and OCI. Respondents who supported consideration of business model agreed with these suggestions. However, some respondents suggested that the IASB also consider how an entity's business model might affect recognition, unit of account and the distinction between liabilities and equity.

22. In paragraphs 23-31, we have included a summary of how respondents thought the business model applied in different areas of standard-setting (eg measurement) to help you to respond to questions 1 and 2 to this paper.

Measurement

23. Most respondents who supported consideration of business model focused on measurement.

24. The Discussion Paper suggested that ‘the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:

    (a) for a particular asset should depend on how that asset contributes to future cash flows; and

    (b) for a particular liability should depend on how the entity will settle or fulfil that liability’.

25. Many respondents interpreted this preliminary view as meaning that the IASB would consider an entity’s business model when selecting an appropriate measurement basis. Some of those who supported the preliminary view stated that basing measurement requirements on an entity’s business model would help provide relevant information to users of financial statements.

Presentation and disclosure

26. Some respondents suggested that the IASB should consider an entity’s business model in the following areas:

    (a) objective of financial statements;

    (b) types of disclosures in the notes to the financial statements;

    (c) entity-specific communication principles;

    (d) discussion of what information should be presented on the face of the primary financial statements rather than in the notes to the financial statements; and

    (e) the boundary of financial reporting.

    However there was little explanation of why these respondents thought that the business model applied in these areas.

Distinction between profit or loss and OCI

27. Some respondents suggested that the definition and content of profit or loss should reflect the entity’s business model.

28. Some preparers who advocate a long-term business model suggested using the business model to identify short-term unrealised gains or losses or volatile information that should be reported in OCI.

Recognition

29. We received two examples of how the business model could have a role in recognition:

(a) a forward contract to buy coal might be an unrecognised executory contract for an energy producer, but might be a recognised financial instrument for a commodities trader.

(b) an item which is a specific bundle of rights to one entity with a trading business model may represent a different bundle of rights to another entity with a held-for-use business model.

Distinction between liabilities and equity

30. Most co-operative organisations and their representative bodies (‘co-ops’) that responded to the Discussion Paper highlighted the specific circumstances of their co-op capital structure. They agreed that the existing definition of equity should be retained. They also suggested that, as an exception, the most subordinated class of financial instruments should be treated as if it were equity if no other instrument meets the definition of equity. They saw this as a valid use of business model in making the financial statements more relevant.

Unit of account

31. A few respondents suggested considering the business model when determining the unit of account. For example, some suggested that asset-liability management (ALM) by insurers might affect the unit of account for these activities.

Questions to ASAF members
1) Do you think that a notion of a business model, or a similar notion, should play a role in setting Standards? If so, how could such a notion help the Board in developing Standards in the following areas: a) Measurement? b) Distinction between profit or loss and other comprehensive income (OCI)? c) Other aspects of presentation and disclosure? d) Recognition and/or derecognition? e) Distinction between liabilities and equity? f) Unit of account? g) Other areas in standard-setting (please describe)? 2) How would you define or describe the notion of business model (or similar notion) that would help in the areas identified in your response to question 1? Is that notion the same for each area, or are different notions needed for different areas?

Is business model the best label?

32. We think that some respondents who support consideration of business model appear to have different notions in mind for different areas in standard-setting. For example:

    (a) Some viewed business model as a broad notion which includes information about an entity's strategies, culture and other information on how it operates. Consequently, they thought that there are many different business models and supported having more detailed disclosures or entity-specific information about how the business operates.

    (b) Some viewed business model as a narrower notion, focusing on how assets (or liabilities) contribute to future cash flows, consistent with the Discussion Paper's approach on measurement.

33. We also note that various organisations have already defined the term business model for other purposes. Using a term that has been described differently could lead to confusion, particularly when management are explaining their results to investors. Examples of such definitions are:

> An organization's system of transforming inputs through its business activities into outputs and outcomes that aims to fulfil the organization's strategic purposes and create value over the short, medium and long term. (International Integrated Reporting <IR> Framework)
>
> A business model describes how an organisation creates, delivers, and captures value (economic, social, or other forms of value). The essence of a business model is that it defines the manner by which the business enterprise delivers value to customers and converts that value into profit. It describes how an enterprise is organised to best meet customer needs, be paid for doing so and make a profit. (Enhanced Disclosure Task Force (EDTF))

34. This raises the question of whether the term business model is a good label for the notions identified for use by the IASB in setting standards.

Question to ASAF members
3) Do you think that 'business model' is a good label for the notion(s) identified in your response to question 3? Why or why not? If not, what label(s) do you suggest and why?

Appendix A
Comments from ASAF members on the business model

Appendix B contains the comments received from ASAF members to the question relating to business model (question 23 to the Discussion Paper).

ASAF member	Comment
Africa	
South African Financial Reporting Standards Council	There may be merit for the Conceptual Framework to also specifically mention areas it doesn't cover in detail. For example, as mentioned above the issue of unit of account might be more appropriately dealt with in detail in individual IFRS, but for the Conceptual Framework to explain the issue. The use of a business model in accounting is also related to the unit of account issue and thus while the Conceptual Framework could deal with issue broadly, when it can be used seems best left to individual IFRS.
Asia-Oceania	
Accounting Standards Board of Japan (ASBJ)	We agree with the IASB's preliminary view that financial statements can be made more relevant if the IASB considers, when newly developing or revising accounting standards, how an entity conducts its business activities. As noted in paragraph 76 of this comment letter, we believe that a relevant measurement basis for an asset or a liability can be determined based on how the asset contributes to future cash flows or how an entity will settle or fulfil the liability. In this context, we believe that the business model often provides useful evidence as to how an asset contributes to future cash flows or how an entity will settle or fulfil the liability. Accordingly, we support the use of the business model notion in the standard-setting process. In December 2013, the European Financial Reporting Advisory Group (EFRAG) and some European standard setters jointly published a Research Paper The Role of the Business Model in Financial Statements. Although the paper noted challenges for providing a universal definition of a business model, it identified the manner in which cash flow is generated and value is created as an important characteristic to identify the business model, and explained the business

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	model focusing on the cash conversion cycle. Furthermore, the paper identified possible criteria that could help the IASB in determining when the business model should be considered, when newly developing or revising accounting standards. Although we do not necessarily agree with every aspect of the paper, we believe that it would be very helpful if the Conceptual Framework explained whether, and if so how, recognition, measurement, and presentation and disclosures should differ depending on how cash flow is to be generated and how value is to be created. Accordingly, regardless of whether the term business model is used in the Conceptual Framework, we recommend that the revised Conceptual Framework include relevant discussions using the notions stated in the previous paragraph.
Asian-Oceania Standard Setters Group (AOSSG)	93. AOSSG members agree that the concept of the business model is very important when the IASB develops or revises particular Standards. As stated in paragraph 6.75 of the DP, measures based on how the value of the asset is likely to be realised can be indicated by current activities (including the business model). Yet there is a mixed view as to whether the concept can be practically defined in the Conceptual Framework. The IASB could consider: (i) describing the concept of the business model as how an entity conducts its business activities, (ii) explaining how such a notion would enhance the achievement of the qualitative characteristics of useful financial information; and (iii) incorporating the notion in relevant chapters of the Conceptual Framework, most notably, the Measurement chapter (refer our comments in paragraph 43 above). 94. Some AOSSG members think the role of the business model concept should, at least in part, be determined or heavily influenced by other concepts - for example, by an identified ideal concept of wealth, in relation to measurement. Arguably, an entity's operating capability, which represents the entity's ability to carry out its activities at the scale determined by its then-existing resources, is the ideal concept of wealth that should be adopted in financial statements, on the basis that it provides the most useful information for helping users to predict an entity's future cash flows. These members believe that applying that concept of wealth would provide insights into the consequences of the entity's business model (for example, management's decision to acquire specialised resources to provide bespoke goods or services would be reflected in the measurement of those specialised resources at current market buying prices, rather than, for example, at current exit prices - this is significant because current exit prices might not reflect the value of those resources to the reporting

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	entity in particular for generating future cash flows). However, an ideal concept of wealth - rather than management's intentions or practices - would determine whether assets and liabilities are measured at current values. For example, the measurement basis for receivables would not depend on whether those receivables are managed for collection of contractual cash flows.
Australian Accounting Standards Board (AASB)	A7 Another reason why the AASB considers that some preliminary views addressing gaps in the Conceptual Framework are seriously inadequate is that they indicate various pervasive issues should be addressed only at a standards level without conceptual underpinnings to guide those standards-level decisions, even though resolving a number of them would seem likely to require an overarching principle. The AASB thinks the Conceptual Framework is the place to establish appropriate overarching principles. Establishing such overarching principles in the Conceptual Framework should minimise the risk that decisions will be ad hoc and inconsistent, and should enhance the IASB's communication with its constituents, because its thinking will be more explicit. This does not preclude also addressing those issues at a standards level; at least some of them would also warrant being dealt with in more detail at a standards level. For example, the 'unit of account' issue noted in paragraph A8(f) below would need standards-level guidance, but that guidance should be developed from concepts. A8 Examples of the types of issues referred to in paragraph A7 above are: (e) the business model concept [paragraph 9.32 says the DP does not define the business model concept, but "the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when it develops or revises particular Standards, how an entity conducts its business activities" (emphasis added)]; ***AASB's conclusion on an ideal concept of wealth*** B136 For the reasons in paragraphs B126 – B135 above, the AASB considers that the ideal concept of an entity's wealth that should be adopted in the IASB Conceptual Framework is operating capability, as described in paragraph 15(b) above.

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	B137 An entity's operating capability represents the entity's capacity being utilised, in contrast with an entity's current cash equivalents commanded, which represent the entity's adaptive capacity (i.e. which relates to the entity's liquidity and capacity to finance alternative business models). Whilst the AASB considers information about an entity's adaptive capacity would be useful to investors and creditors in making resource allocation decisions (e.g. in assessing how the entity would be placed in coping with unexpected adverse events, and how nimble the entity might be in financing opportunities to undertake different activities), it considers it is more useful to measure the elements in the primary financial statements on the basis of the activities it currently undertakes. The AASB thinks information about adaptive capacity should be provided in notes. B138 In addition to providing, in the AASB's view, the most useful measures of assets and liabilities for helping meet the common information needs of investors and creditors in assessing the entity's capability to generate future cash flows (see paragraph B128 above), current market entry prices have the advantage of being more readily obtainable than current market exit prices. This is because entities regularly replace most of the economic resources they use, but only sell some of those economic resources. (The exception to this advantage is when entities buy and sell economic resources in the same market, in which instances information about current market entry prices and current market exit prices would be equally readily available.) B139 For the reasons discussed in paragraphs B119 – B124 above regarding the deficiencies of historical cost as a measurement basis in meeting the objective of providing information useful for resource allocation decisions by investors and creditors, the AASB does not support adopting the concept of wealth associated with historical cost: namely, invested money capital. B140 The AASB considers that adopting operating capability as the ideal concept of wealth would address, to a significant degree, the conceptual role of the entity's business model. An entity's operating capability takes into account how management has chosen to 'configure' the entity's capability to provide goods and services, while measuring it using current market buying prices[3] (rather than ascribing the entity's own values to that

[3] Current market buying prices are used, except when an asset's recoverable amount is less than its current market buying price.

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	capability[4]). However, an entity's business model would not determine which measurement basis to apply, in concept, to an asset or a liability. Using an entity's business model to decide when to remeasure an asset or a liability would be incompatible with adopting operating capability (or, for that matter, any other current value) as the ideal concept of wealth. This view is consistent with the AASB's view that, in concept, historical cost is irrelevant as a measurement basis for assets and liabilities. B141 As indicated in paragraph B137, adopting operating capability as the concept of wealth for measuring recognised assets and liabilities would not meet all of the common information needs of investors and creditors. Nevertheless, the AASB considers that: (a) it is essential, in concept, to identify an ideal concept of wealth; and (b) operating capability is the concept of wealth that best meets those common information needs.
Chinese Accounting Standards Committee	We agree that the IASB should consider business model in standard-setting process and such concept has become an important guidance to determine relativity to users. We suggest the IASB to further study on the possible definition of business model.
Europe	
Accounting Standards Committee of Germany	Generally, we are supportive of the view that the IASB should consider the economic nature and substance of the entity's business activities, including the reflection of the entity's business environment, when developing or revising particular Standards to provide relevant information to users. We think the preliminary views developed in the DP regarding the selection of measurement, i.e. selection of measurement for assets and liabilities depending on their contribution to future cash flows, reflect a good example for such a standard-setting approach. Therefore, we think the revised Conceptual Framework could highlight that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

4 Current market buying prices represent the prices other market participants currently demand for providing the entity's economic resources.

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	We would be concerned about an explicit reference to the business model without clarifying implications for developing or revising IFRSs; we are not yet convinced that such a reference would strengthen the conceptual robustness of the Conceptual Framework, specifically as there is no common understanding of what a business model constitutes. Furthermore, we understand that those who are in favour of adding the business model concept to the Conceptual Framework think the business model notion is in-line with the qualitative characteristics of useful financial information in section 3 of the Conceptual Framework. However, taking this view it can be argued that the core idea of the business model is already covered by qualitative characteristics, i.e. relevance and faithful representation. Additionally, we are concerned about scenarios where constituents refer to using a business model notion to avoid unpopular accounting requirements, i.e. to consider the business model as an overruling concept in relation to other concepts in the Conceptual Framework. In our view a reference in the Conceptual Framework to the business model notion should not lead the development of industry-specific accounting requirements.
European Financial Reporting Advisory group (EFRAG)	**EFRAG believes that the business model notion should be referred to in IASB's financial reporting requirements on a systematic basis and thus be part of the IASB's *Conceptual Framework*.** 244 The role of the business model for financial statements has been subject to extensive research conducted through EFRAG s proactive project undertaken jointly with the French ANC and the UK FRC. The final results of this project, the Research Paper The Role of the Business Model in Financial Statements, was issued in December 2013. 245 In addition to the Research Paper, EFRAG and the standard setters from France, Germany, Italy and the United Kingdom issued a Bulletin The Role of the Business Model in Financial Reporting in June 2013 as part of a series of papers to promote discussion on topics related to the IFRS Conceptual Framework debate. 246 Both the Research Paper and the Bulletin discuss the following issues: (a) The use of the business model in IFRS; (b) An assumed meaning of the term;

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	(c) The conceptual discussion on the business model; (d) A discussion on the distinction between the business model and management intent; and (e) Implications of the business model for IFRS. 247 A summary of this discussion is provided below. *An assumed meaning of the term* 248 Both the Research Paper and the Bulletin use an assumed meaning of the term. The assumed meaning focuses on the value creation process of an entity, i.e. how the entity generates cash flows. In case of non-financial institutions, it represents the end-to-end value creation process or processes of an entity within the business and geographical markets it operates. *The conceptual discussion on the business model* 249 To assess whether the business model could, or even should, play a role in financial reporting, the Research Paper and the Bulletin discuss whether such a role is essential for, or enhances the response to, the key qualitative characteristics in the IASB Conceptual Framework. 250 Based on this assessment, the tentative view expressed in the Bulletin is that the business model should play a role in financial reporting, including the financial statements. Not doing so would result in less relevant information, would not lead to a faithful representation of economic reality, would harm comparability, and would make the financial statements less understandable. For this reason, the role of the business model should be explicitly incorporated in the IASB literature. *A discussion on the distinction between business model and management intent* 251 The Research Paper and the Bulletin provide a discussion on the similarities and differences between the business model and management intent, an issue which has been debated extensively in the academic

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	literature. 252 An important similarity between the business model and management intent is that they are both entity-specific, i.e., the financial statements reflecting both the business model and management intent present what actually happened and how the entity performed. In other words, the financial statements provide information that is useful for an assessment of management s accountability, or stewardship. The resulting information therefore meets the relevance criterion. Both the business model and management intent are also verifiable, if they are documented with the necessary level of detail. Some take these similarities one step further and argue that the business model is the same as management intent or that the two notions are connected, at least, for purposes of financial reporting. 253 The tentative view expressed in the Bulletin is that there is a distinction between the business model and management intent. Both notions provide relevant information, but business models tend to focus on the larger picture, are generally more stable, and usually require much less documentation to make them verifiable. *Implications of the business model for Conceptual Framework* 254 EFRAG believes that financial reporting should portray the business model in order to faithfully represent the economic reality of the reporting entity, since it focuses on the actual, past and current transactions and events. Therefore, once the business model is identified and observed, the accounting treatment related to a business model should be derived from the business model. 255 EFRAG, ANC, ASCG, OIC and FRC do not believe that the current status quo, i.e. the business model being referred to in financial reporting requirements only on an ad hoc basis, explicitly or implicitly, at Standards level should be maintained. As a consequence, they support the development of a proper rationale for the use of the business model notion as part of the Conceptual Framework, with appropriate guidance for standard setting purposes. 256 Such guidance would help identify whether and when the business model notion should be explicitly incorporated on individual Standards level. The Conceptual Framework should also require that the business

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	model be based on observable and verifiable evidence. 257 If the business model approach is applied, its meaning would need to be described in the Conceptual Framework and in individual accounting Standards that explicitly incorporate the term. Although we acknowledge that the assumed meaning provided in paragraph 248 could probably be further developed, in our opinion a very general definition/identification of the business model notion similar to the one presented above would suffice for the Conceptual Framework. Nevertheless, if the business model notion would be explicitly incorporated in individual Standards, then the notion would need to be defined/identified in more detail to be operational. 258 Furthermore, Standards should reflect faithfully an entity s business model or models. If that is not the case, EFRAG believes that financial reporting requirements have not been developed appropriately. 259 Additionally, the Conceptual Framework should highlight and illustrate how the business model can play a role in (i) recognition, (ii) measurement, (iii) presentation and (iv) disclosures. Some suggestions are presented hereafter. *Playing a role in recognition* 260 If the business model plays a role in recognition, an item could be an asset for some entities and not recognised by others. An example can be found in IAS 39, paragraph 5, which states that the Standard should be applied to “contracts to buy or sell a non- financial items that can be settled net in cash … with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non- financial item in accordance with the entity s expected purchase, sale or usage requirements. This means that a contract to receive an amount of coal is a non recognised executory contract for an energy producer, but a recognised financial instrument for a commodities trader. *Playing a role in measurement* 261 Measurement (and the related accounting policy choice) is an obvious place where the business model should play a role, because current IFRS require, or permit, different measurement requirements depending on how an

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	asset or a liability, or a group of assets or liabilities, contribute to the entity s cash flow generation. Please see paragraph 138 above in Section 6 Measurement which addresses the measurement of inventory. 262 Furthermore, EFRAG also believe that the business model provides an essential basis for understanding how assets and liabilities are used within a certain entity and thus how the assets contribute to future cash flows and how liabilities will be settled or fulfilled. The DP notes (paragraphs 6.75-6.96) that the way an asset will ultimately contribute to cash flows will often not be certain and that for most assets there are choices that may change. The business model thus actually limits management discretion (management intent) in selecting the appropriate measurement basis. *Playing a role in presentation* 263 Presenting assets, liabilities, income and expenses in such a way that investors can understand how they contribute to the entity s cash flow generation can in itself be a way of representing the entity s business model. Segregating assets and liabilities which play a different economic role in the entity, for example helping provide optimum daily cash management versus creating liquidity for acquisitions and capital expenditures, would provide users with both a better basis for looking at financial results and forming expectations of future financial results. 264 To a certain extent, this was the approach presented in the IASB-FASB joint project Financial Statements Presentation, which proposed that separation should not only be made into operating, investing and financing activities, based on the nature of the assets and liabilities, but also on the economic role they played in the activities of the entity. These underlying principles were widely welcomed (although constituents active in the financial services industry commented that such distinction was not always easy to make), and such a presentation was supportive of more meaningful sub-totals and performance indicators, such as operating profit. *Playing a role in disclosures* 265 Business models could also play a role in the determination of priorities in information provided. In order to

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	help users to clearly identify the most important elements of information, it could be assumed that the most important and relevant information should be given priority in the primary financial statements. The business model notion would help in identifying this most important information. Complementary (secondary) information would be presented somewhere else, for example in the notes to the financial statements. In particular, if there are two ways of measuring the same item or transaction, the one that is more closely related to the representation of the effects of the application of the business model in terms of cash flow generation should be placed in the primary financial statements and the complementary one in the note disclosures. 266 For more analysis on the above issues, please refer to the Research Paper The Role of the Business Model in Financial Statements, which EFRAG and the standard setters from France and the United Kingdom issued in December 2013.
Spanish Accounting and Auditing Institute	ICAC is of the view that the concept of business model is essential in financial reporting. We would like further analysis about concept and definition of business model in order to be included in CF.
United Kingdom Financial Reporting Council	*The business model* 2.39 In our view, the Conceptual Framework should acknowledge that financial statements should provide information that assists in an assessment of the entity's business model. Financial statements should not simply provide an inventory of assets and liabilities and information on changes in them, but should portray how the entity uses its assets and liabilities in order to create value. A shareholder has a stake in the success (or failure) of a business, rather than simply a portion of the entity s assets and liabilities. 2.40 Much of financial reporting already reflects a business model; for example by distinguishing inventory from property, plant and equipment; and revenue from other receipts. Thus introducing the notion of a business model would be consistent with rather than a radical departure from current practice. 2.41 As mentioned above, providing information to assist such an assessment is clearly required by an accountability objective. It is also relevant under a decision- useful objective as the predictive value of income

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	and expenses that relate to an entity's business model is significantly different from that of other income and expenses. 2.42 We suggest that it would be appropriate for the Conceptual Framework to provide a general description of the business model, rather than a specific definition. This should emphasise that the business model focuses on the means by which an entity creates value. It should be noted that the business model for most (probably the majority) of entities involves the obtaining of inputs through exchange transactions, and using those inputs, usually after some kind of process to provide goods and services to customers from which revenue is obtained. Reporting the results of such a business model clearly requires information on the cost of inputs and their transformation and on the revenues obtained from them. Other business models involve the acquisition of assets in order to benefit from gains resulting from their increase in value: in such a case reporting assets at current value may be helpful. 2.43 The Discussion Paper notes some instances where its proposals have regard to the way in which the entity conducts its business activities. However, a general reference to the relevance of information that reflects the business model is required to ensure that it is considered in the development of new standards, or other parts of the Conceptual Framework. 2.44 In our view, a close relationship between the business model and financial reporting can significantly enhance comparability by promoting consistency of treatment by entities within a sector. This will greatly assist investors whose analysis is often focussed on detecting differences between entities within the same sector. 2.45 Furthermore, we do not believe that providing a discussion of the business model concept in the Conceptual Framework would necessarily lead to a serious loss of comparability. Its main influence is likely to be in the development of standards. It might be reflected by appropriate definitions of terms and by prescribing the circumstances in which particular accounting treatments would be used, rather than simply by permitting an unconstrained choice of treatment. Consistent with our view that the Conceptual Framework should provide a set of ideas that need to be considered together in the development of standards, the Conceptual Framework should not suggest that the business model should override all other considerations. 2.46 Cases where the business model would influence the Conceptual Framework are noted in paragraphs 6.10,

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	6.12-6.14, 6.17, 7.5, 7.19, 8.3, 8.7 and 8.8 of this response. Further discussion of the business model is in the Getting a Better Framework Bulletin The Role of the Business Model in Financial Reporting.
The Americas	
Canadian Accounting Standards Board	96. The Discussion Paper does not define ‘business model’. One view might be that the business model is a choice made by management on how to manage the entity’s assets and operations. We would be concerned if the accounting for assets (and liabilities) could be determined based on management intent. This would permit an entity to decide to manage assets in a certain manner in order to achieve a desired accounting result. It would also affect comparability between similar entities if the respective managements chose different business models. 97. We think that the type of business may determine the most appropriate accounting. Examples in current IFRSs are broker-dealers, investment companies and investment properties. The determining factor here is the business the entity is engaged in, which is a matter of fact rather than of management intent. 98. Whether an item is recognised as an asset (or liability), or when it is recognized, should not be affected by the type of business or the business model selected by management. We agree that the type of business might affect the choice of the basis of measurement. The examples in the previous paragraph primarily relate to measurement. However, we think that this will be rare and should be driven by the concepts in the Conceptual Framework for the determination of the measurement basis. 99. The business model may play a role in presentation and disclosure. The business model will often reflect management s views of the risks associated with different assets. Differences in risk affect aggregation/ disaggregation in the financial statements and the level of detail provided in the notes to the financial statements. For example, the management approach underlying segment reporting is based on management s business model.

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Group of Latin American Standard Setters (GLASS)	We found unanimous support for the preliminary view that the financial statement can be made more relevant if the IASB considers, when developing or revising particular standards, how an entity conducts its business activities. This concept is highlighted in the IFRS 9, Financial Instruments, and we believe it could also be very useful in other standards. However, we believe it may be necessary to define the concept of business model to facilitate its universal application in all areas of financial reporting, and not just for financial instruments, whose classification clearly depends on the business model. We find the definition of a business model proposed by the International Integrated Reporting Council (included in paragraph 9.29 of the DP) to be adequate and consistent with other definitions we have seen. Nevertheless, we recommend certain changes and propose the following definition: The business model is the chosen system of inputs, business activities, outputs and outcomes that aims to create, deliver and capture value over the short, medium and long term.

Appendix B
Summary of EFRAG's research paper on the business model

35. This appendix summarises EFRAG's research paper on business model[5].

36. The research paper stated that a business model concept focuses on how an entity generates cash flows[6]. The research paper also suggests that financial reporting that reflects an entity's business model provides information about the generation of cash flows and the creation of value.

37. The research paper noted that entities create value in different ways, and the cash flow cycle often differs depending on the way the value is created. The research paper suggested that the following attributes could be used to determine the different types of business models and, hence, justify different accounting:

    (a) The length of the activity cycle: for example, whether the asset has been purchased and sold in a very short time.

    (b) How inputs are used: for example are inputs used in the production process or sold without any change in their nature.

    (c) How outputs are used to generate cash.

    (d) The types of risks related to the activity.

    (e) The degree of certainty in the generation of cash flows.

    (f) The degree of capital intensity.

38. The research paper suggested that for accounting purposes, it would be necessary to determine which attribute provides the most useful information to investors or analysts. However, it also discussed whether alternative accounting treatments should be permitted to reflect the different business models (ie on how an entity generates value or cash flows on its assets and liabilities).

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[5] http://www.efrag.org/Front/n1-1243/EFRAG--ANC-AND-FRC-ISSUE-A-RESEARCH-PAPER--THE-ROLE-OF-THE-BUSINESS-MODEL-in-FINANCIAL-STATEMENTS.aspx

[6] EFRAG published a research paper in December 2013 seeking views on its proposals on how it characterised what is a business model concept and why it should play a role in financial reporting. The comment period ends on 31 May 2014.

39. The research paper also suggested that the business model should continue to play a role in financial reporting, but not on an ad-hoc basis. Therefore, the research paper suggested that a business model concept should be included in the *Conceptual Framework* with appropriate guidance for standard setting. The research paper suggested some possible criteria for assisting standard setters to assess when the business model needs to be considered for standard-setting purposes.