

## STAFF PAPER

March 2014

## IASB Meeting

| Project     | Conceptual Framework             |  |                     |
|-------------|----------------------------------|--|---------------------|
| Paper topic | Feedback summary: business model |  |                     |
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**Purpose of paper**

1. This paper summarises the feedback received on the discussion on the business model in Section 9 of the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*.
2. This paper provides a high level summary of the comments received. Where appropriate, we will provide a more detailed breakdown of the comments for future meetings.

**Overview**

3. In summary:
  - (a) Most of the respondents who commented supported the IASB's suggestion to consider how an entity conducts its business activities when it develops or revises Standards. Many viewed that notion as being similar to the concept of a business model. However, there were mixed views on whether the business model concept should be considered fundamental to financial reporting or should play a more limited role.

- (b) Many respondents thought that the IASB should, in the *Conceptual Framework*, define the business model concept or provide additional guidance on it.

### **Structure of paper**

- 4. This paper is structured as follows:
  - (a) Background (paragraph 5)
  - (b) Summary of feedback (paragraphs 6–21)
    - (i) Is an entity’s business model relevant when developing or revising Standards? (paragraphs 6-12)
    - (ii) Exploring the meaning of the business model concept (paragraphs 13-19)
    - (iii) Use of the business model concept (paragraphs 20-21).

### **Background**

- 5. In the Discussion Paper, the IASB suggested that it should not define the business model concept. However, the IASB’s preliminary view was 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.

### **Summary of feedback**

#### ***Is an entity’s business model relevant when developing or revising Standards?***

- 6. Most of the respondents who commented expressed the view that the IASB should consider an entity’s business model when it develops or revises Standards. They agreed that consideration of an entity’s business model may provide more relevant information to users of financial statements and thus meet the objective of financial reporting. A few added that consideration of the business model concept could reduce

the risk of the IASB developing Standards that try, but fail, to provide a ‘one-size-fits-all’ solution.

7. However, respondents had mixed views about the importance of the business model concept. Some respondents stated it should be considered fundamental to financial reporting. Some other respondents thought that the business model concept should be considered in limited circumstances.
8. Those who believe that the business model is fundamentally important gave the following reasons:
  - (a) Using the business model concept allows entities to more faithfully represent the economic substance of the transaction, or better reflects the industry in which an entity operates. Among other things, this could also help reduce the volume of disclosure requirements.
  - (b) Reflecting an entity’s business model in the financial statements would improve comparability. Differences between entities would be clearer to users.
  - (c) Consideration of the business model could enable users to better understand complex entities that use the same types of assets and liabilities in different business models.
9. Respondents who thought that the business model should be considered in more limited circumstances gave the following reasons:
  - (a) There are many types of business models, and the IASB may not be able to develop Standards that would represent the different business activities, the linkages between different activities and the ways in which those linkages are managed.
  - (b) The business model concept is too ambiguous to use as a basis for developing Standards and could be subject to management manipulation. Consequently, the financial information disclosed may not represent the underlying economics.
  - (c) Over-emphasising the business model concept could reduce comparability among different entities.

... Entity specific information is obviously of great interest to users: no two sets of accounts are the same. Management commentary provides much entity-specific detail, including non-GAAP numbers, which users may find helpful. However, we are wary of the IASB routinely adopting a business model approach in setting standards. Accounting standards are an antidote to the propensity of companies to prepare disparate accounts. They minimise management subjectivity and enhance consistency over time and comparability across companies. *Chartered Financial Analyst Society of the UK (CFA, UK)*

- (d) Over-emphasising the business model could lead the IASB to produce more industry-specific Standards.
10. A few respondents did not think that the IASB should explicitly consider the business model concept in the *Conceptual Framework* because they thought it was already a consideration when the IASB develops Standards, as part of the qualitative characteristic of ‘faithful representation’.
  11. Some respondents thought that the IASB should not consider the business model concept in the *Conceptual Framework* because they thought that this issue should only be addressed at the Standards level or they thought that applying this concept would result in the IASB not developing principle-based Standards.
  12. A few respondents stated that they could not provide a view on the business model concept because they think that this concept and its implications need to be considered further.

### ***Exploring the meaning of the business model concept***

13. As noted earlier, the IASB did not define the business model concept in the Discussion Paper.
14. However, 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*. If it is not defined, different industries would have different interpretations of the business model concept. They believe that

defining or describing the business model concept will facilitate its application in all areas of financial reporting, not merely in particular cases, such as financial instruments, in which existing Standards already refer explicitly to an entity's business model.

15. Some respondents suggested how the business model should be described or defined. Some suggestions were similar to, or based on, the International Integrated Reporting Council's Draft of the *International Framework*.

A business model is the chosen system of inputs, business activities, outputs and outcomes that aims to create value over the short, medium and long term.<sup>1</sup>

16. Some preparers suggested that a business model concept should be more closely linked to management's intention on how the individual instrument or asset/liability will be used or settled. However, a few respondents thought that management's intention was distinct from the business model. One suggestion was that business models tend to focus on the larger picture, are generally more stable, and usually require much less documentation to make them verifiable, than management's intention.

17. Other suggestions were as follows:

- (a) A business model concept should include the characteristics identified in the guidance from the Enhanced Disclosure Task Force (ie identification of the entity's risk culture, procedures and strategies to support the culture).
- (b) An entity's business model is based on the nature of the business entity (for example, rate-regulated, for profit), how the entity generates or expends its resources, the major industry (or industries) in which it classifies itself and management's expectations about how the entity will grow its 'earned equity'.
- (c) The IASB should give more consideration to investors that have a longer-term business model outlook.

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<sup>1</sup> The IIRC's definition of a business model, now finalised, is as follows:  
*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.*

- (d) The IASB should consider developing a separate framework for co-operatives because they have a distinct business model.

18. A few respondents were concerned about using the term business model at all.

It is important for accounting to reflect actual business as it is conducted. However, the IIF SAG reiterates its concern that there is a danger of confusion if an accounting concept is labeled as a business model. Inevitably, a formal accounting concept is unlikely to coincide with what investors, management or regulators mean by business model, a point of high importance when business models (in the common usage of the term) are under intense scrutiny as a result of market, economic, and regulatory changes. Therefore, the Board might consider whether a different term or expression than business model should be used. *Institute of International Finance*

19. Some respondents did not think that the IASB needed to define or provide additional guidance on the business model concept, arguing that:

- (a) The concept is well understood.
- (b) The business model concept would be too difficult to define. In addition, there appears not to be a standard definition in academic literature and the concept cannot be understood separately from an understanding of business strategy.

***Use of the business model concept***

20. The Discussion Paper identified three areas in which the business model concept might be relevant. Most respondents agreed with the areas identified. The agenda paper sections that summarise the comments raised in those areas are also noted below:

- (a) 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. (Agenda Paper 10G)

- (b) 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. (Agenda Paper 10H)
  - (c) 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. (Agenda Paper 10I)
21. Some preparers thought that the business model concept is also relevant in the following situations (the agenda papers that summarise comments relating to those situations are also identified below):
- (a) determining the unit of account (Agenda Paper 10L);
  - (b) considering the distinction between liabilities and equity (Agenda Paper 10F); and
  - (c) deciding whether to recognise an asset or liability (Agenda Paper 10C).