

**IASB® meeting**

Project	<b>Management Commentary</b>		
Paper topic	What an entity's business model is		
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**Purpose of this paper**

1. At the October 2019 meeting, the staff presented their research on business model and identified the following questions for the Board to consider in developing guidance on business model for the revised Practice Statement 1 *Management Commentary* (Practice Statement)<sup>1</sup>:
  - (a) what an entity's business model is;
  - (b) what the objective of describing business model in management commentary is;  
and
  - (c) which types of information about business model should be discussed in management commentary.
2. This paper provides the staff's analysis and recommendations on the first question and asks the Board for decisions. The staff will provide in a future paper their recommendations on the objective of describing business model and on types of information to be discussed about it in management commentary.

<sup>1</sup> The guidance on business model will be included in the revised Practice Statement as well as guidance on other content elements (topics that are expected to be discussed in management commentary to meet primary users' information needs)—strategy, risks and operating environment and performance, position and progress.

### Structure of this paper

3. This paper is structured as follows:
  - (a) background (paragraphs 6–9);
  - (b) staff analysis and recommendations on whether, and if so how, the explanation of the business model should refer to:
    - (i) value creation and generating cash flows (paragraphs 13–23);
    - (ii) purpose of the entity (paragraphs 24–29);
    - (iii) elements of business model (paragraphs 30–36); and
    - (iv) business model being a matter of fact (paragraphs 37–39);
  - (c) illustrative drafting for the explanation of an entity’s business model (paragraphs 40–41);
  - (d) Appendix A—Extracts from the Board’s guidance on business model;
  - (e) Appendix B—How other standard-setters explain what business model is.

### Summary of staff recommendations

4. The staff recommend that the revised Practice Statement explains the meaning of an entity’s business model by reference to:
  - (a) value creation for the entity itself—and that the explanation clarifies that the notion of value created for the entity is related to the entity’s ability to generate cash flows and can be affected by value created or destroyed by the entity for those parties with which the entity has relationships that the entity depends on for its future success;
  - (b) the entity’s purpose that the entity’s business model seeks to achieve;
  - (c) the elements of a business set out in IFRS 3—inputs, processes and outputs; and
  - (d) business model being a matter of fact and observable through the entity’s actions.

5. In addition, the staff recommend that the revised Practice Statement<sup>2</sup> requires management to discuss the impacts of the operation of the entity’s business model if those impacts could affect the entity’s ability to generate cash flows in the future.

## Background

6. In October 2019 AP15B *Introduction to business model* the staff provided an overview of guidance issued by the Board on the business model and related notions of ‘business’ and ‘business activities’ (see Appendix A for extracts from the Board’s guidance):
- (a) The existing Practice Statement identifies ‘nature of the business’ as a content element and:
    - (i) explains that primary users need a description of the business to help them gain an understanding of the entity and of the external environment in which the entity operates. That information serves as a starting point for assessing and understanding an entity’s performance, strategic options and prospects.
    - (ii) identifies broad types of information about the business that management may consider including in management commentary. Those types of information include information about the entity’s structure and how it creates value, about the entity’s main products, services, business processes and distribution methods and about the entity’s operating environment.
  - (b) The *Conceptual Framework for Financial Reporting (Conceptual Framework)* and IFRS 9 *Financial Instruments* (i) discuss the fact that the nature of an entity’s business activities or its business model affect the amount, timing and uncertainty of an entity’s future cash flows and (ii) address consequences of that fact for selecting an accounting treatment that provides relevant information and a faithful representation. IFRS 9 focuses on specific types of business model—those for managing an entity’s financial assets.

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<sup>2</sup> Although the Practice Statement would not be mandatory, an entity would need to comply with its requirements if the entity asserts that its management commentary complies with the Practice Statement.

- (c) IFRS 3 *Business Combinations* provides a definition of a business and identifies three elements of a business: inputs, processes and outputs.
7. The staff also reviewed other standard-setters' guidance on the business model.<sup>3</sup> Few standard-setters explain what is meant by 'business model'. Where such explanations are provided, they most commonly refer to 'value creation' or similar notions rather than to generating cash flows for the entity (see Appendix B). Some descriptions also refer to the entity's purpose and the elements or components of an entity's business model.
8. In addition to reviewing guidance issued by other standard-setters, the staff considered the findings of the International Integrated Reporting Council's Technical Collaboration Group's research into business model definitions. Their report *Business Model Background Paper for <IR>* states that business model definitions in academic literature most often refer to:
- (a) value creation or ability of an entity to make money or generate revenues or returns;
  - (b) the entity's purpose; and
  - (c) elements or components of business model—inputs, activities or processes, and outputs and outcomes.
9. The staff did not discuss the definition of an entity's business model with the Management Commentary Consultative Group (MCCG). However, commenting on the staff's proposals for types of information that need to be discussed in management commentary, some MCCG members suggested that there is a need to consider the link between business model, value creation and net cash inflows to the entity; and the link between business model and the entity's purpose.

### **Staff analysis and recommendations**

10. As indicated in paragraph 2, the staff expect to provide in a future paper recommendations for guidance on the objective of describing business model and on the types of

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<sup>3</sup> See paragraphs 20–24 of October 2019 AP15B.

information about business model that would need to be provided in management commentary to meet common information needs of primary users.

11. The staff think that it would be helpful to frame that guidance by explaining in it what an entity's business model is. This could help avoid ambiguity because, as mentioned in paragraphs 7–8, there is no single widely accepted definition of business model. Consequently, such an explanation may help management provide more specific and useful descriptions of an entity's business model.
12. In developing recommendations for explaining the meaning of business model, the staff considered whether, and if so, how to reflect the common themes appearing in the definitions or explanations of business model provided by other standard-setters and in accounting literature (see paragraphs 7–8), in particular:
  - (a) value creation and generating cash flows (paragraphs 13–23);
  - (b) the entity's purpose (paragraphs 24–29);
  - (c) elements or components of the business model (paragraphs 30–36); and
  - (d) business model being a matter of fact (paragraphs 37–39).

***Note on terminology – 'business model'***

- The existing Practice Statement does not use the term 'business model'. However, most stakeholders, including users and preparers, as well as many narrative reporting frameworks and guidelines and academic literature, commonly refer to 'business model'. Some existing IFRS literature (IFRS 9) uses the term 'business model' although in a narrow context, ie to refer to business models for managing an entity's financial assets.
- The staff think that although the Board has used different terms in different Standards, the notions of 'business', 'business activities' and 'business model' are related and intended to describe the same thing—what an entity does and how it does it.

- In the *Conceptual Framework* the Board decided not to use the term ‘business model’ as an overarching concept. In the staff’s view, that is because:
  - in developing Standards, that concept may need to be used at various levels of specificity, depending on the purpose and scope of the Standard. A single overarching definition could be too specific in some contexts and too generic in others. Indeed, the staff envisage that the description of a business model needed in management commentary is likely to be highly specific—encompassing, for example, supply change management, production processes and distribution channels. In contrast, the description of the business models covered by IFRS 9 is at a much more generic level; and
  - the term ‘business model’ is used with a range of different meanings by various organisations.
- The Board noted that the concept of business activities discussed in the *Conceptual Framework* can be further explained and developed by the Board in developing Standards. The staff think that using the term ‘business model’ and explaining it in the revised Practice Statement would be in line with this vision and would be more suitable and understandable to the readers of the document.

### ***Value creation and generating cash flows***

13. As mentioned in paragraph 6(b), the *Conceptual Framework* and IFRS 9 discuss the fact that the nature of an entity’s business activities or its business model affect the amount, timing and uncertainty of an entity’s future cash flows.
14. The focus on future cash flows is also important in the Management Commentary project. In November 2018, the Board discussed and broadly agreed that the objective of management commentary focuses on meeting the information needs of primary users,

including their needs for information useful for assessing the amount, timing and uncertainty of (prospects for) future net cash inflows to the entity, and its management’s stewardship of the entity’s economic resources. November 2018 AP15A *The objective of management commentary* emphasised the importance of providing in management commentary information for assessing cash flows across the whole time horizon of the entity’s future cash flows—long, medium and short term.

15. The staff’s proposals for guidance on business model discussed with the MCCG also focused on providing guidance that would promote provision of information useful for primary users, in particular for their assessment of prospects for future net cash inflows to the entity.
16. The focus on cash flows was widely supported by MCCG members and by stakeholders in other outreach performed by the staff. However, some members of the MCCG suggested that ‘cash flow generation’ could be perceived as implying a shorter time horizon than ‘value creation’. In their view, referring to value creation in explaining business model could highlight that information about business model should cover short, medium and long terms.
17. The staff note that the existing Practice Statement already includes a brief mention of value creation stating that the description of the nature of the business may include ‘how it creates value’.<sup>4</sup> Other standard-setters’ explanations and definitions of the business model in academic literature also commonly refer to ‘value creation’ (paragraphs 7–8).
18. The staff agree that to promote a longer-term view in management commentary, it could be helpful to retain the reference to ‘value creation’ and increase its prominence by linking the explanation of an entity’s business model to how the entity creates value.
19. However, including a general reference to value creation may be understood differently because there is no common understanding of what ‘value’ means, how it can manifest itself and for whom it is created. Therefore, the staff think that the revised Practice Statement would need to clarify what is meant by value creation and how this notion reconciles with the notion of cash flow generation. Clarifying the Board’s view on the link

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<sup>4</sup> See paragraph 26(e) of the Practice Statement.

between business model, value creation and generating cash flows would help preparers understand how broad their description of the business model should be.

20. The Board’s focus on the primary users means that the notion of value creation in the revised Practice Statement would need to focus on the value created by the entity for itself because that value affects the returns to primary users. In operating its business model, an entity creates or maintains value for itself if it creates, enhances or maintains its ability to continue generating cash flows. An entity can also destroy value for itself if it does not maintain its ability to generate cash flows, or if that ability is impaired.
  
21. Some see ‘value creation’ as being wider than creating value for the entity, and they suggest it should cover value creation for a wide range of stakeholders other than the primary users, for example, for customers, employees, or society at large. This wider view of value creation is inconsistent with the Board’s focus on primary users, except in those cases when value is created (or destroyed) for those parties with which the entity has relationships that it depends on for its future success if the creation (or destruction) of value for those parties can affect the entity’s ability to generate cash flows—and value—for itself. For example, if the entity’s operations lead to increased pollution in the area, this could have an adverse effect on its local community and the entity may be required to curtail those operations. This would impair the entity’s ability to generate cash flows and so would reduce value for the entity.
  
22. The staff’s recommended view of value creation is largely consistent with the explanation of value creation in the International Integrated Reporting <IR> Framework which—similarly to the Practice Statement—is intended to meet the needs of providers of financial capital. The <IR> Framework states:

Providers of financial capital are interested in the value an organization creates for itself. They are also interested in the value an organization creates for others when it affects the ability of the organization to create value for itself, or relates to a stated objective of the organization (e.g., an explicit social purpose) that affects their assessments.

24. For the reasons given above, the staff recommend:
- (a) linking the explanation of an entity’s business model in the revised Practice Statement to how an entity creates value for itself; and
  - (b) clarifying that the notion of value created for the entity is related to the entity’s ability to generate cash flows and can be affected by the value created or destroyed by the entity for those parties with which the entity has relationships that the entity depends on for its future success (see paragraph 40 for the staff’s suggested illustrative drafting).

***Note on terminology – ‘cash flows’***

The *Conceptual Framework* and IFRS Standards commonly use the phrase ‘net cash inflows to the entity’ to refer to the cash flows resulting from cash inflows to the entity and cash outflows from the entity. The staff note that this technical phrase is rarely used by stakeholders in discussing management commentary, who more commonly refer to ‘cash flows’ or ‘future cash flows’. The staff think that using the simpler phrase ‘cash flows’ would not confuse the readers of the revised Practice Statement and we plan to use this simpler term in developing recommendations on the project. The staff will consider in drafting how to introduce the simpler phrase in the exposure draft of the revised Practice Statement and explain that those cash flows can be both positive and negative.

***Purpose of the entity***

25. As noted in paragraphs 7–8, some definitions or explanations of an entity’s business model refer to the entity’s purpose.
26. In discussions with the Board’s consultative groups, the staff presented separately their proposals for guidance on business model and on strategy, including the entity’s purpose. The proposals on strategy included a proposal to promote a discussion of strategy across all time horizons by requiring management to discuss three components of the entity’s strategy:

- (a) purpose, which the staff described as a long-term component of an entity’s strategy—sometimes presented as an entity’s mission statement;
- (b) objectives to be achieved in pursuit of the entity’s purpose—a medium-term component of strategy; and
- (c) plans set to achieve the entity’s objectives—a short-term component of strategy.

The staff did not propose setting rigid boundaries between the three time horizons, because the staff’s main aim was to promote a discussion covering all time horizons, not to divide the discussion artificially into separate components.

- 27. The MCCG, the Global Preparers Forum and Capital Markets Advisory Committee were largely supportive of the staff’s proposed three-component description of strategy. However, some members strongly emphasised that an entity’s strategy, and in particular its purpose, is inexplicably linked to the entity’s business model and advocated explaining more clearly how the entity’s purpose drives the operation of its business model.
- 28. The staff agree that linking the descriptions of the entity’s business model and of its strategy, including purpose, in the entity’s management commentary would be helpful and are developing recommendations for guidance on promoting coherence between information on business model and information on strategy for a future paper.
- 29. The staff also considered whether it could be helpful to refer to an entity’s purpose in the explanation of what an entity’s business model is in the revised Practice Statement. The staff think that including such a reference may:
  - (a) indicate to preparers that their description of an entity’s business model needs to help users understand how the entity’s business model seeks to meet its long-term purpose. In some cases, an entity’s purpose or mission may be stated in terms of social, environmental, public good or other goals. For example, an entity’s stated purpose may be to cure diabetes or create a greener way to travel. Given the Board’s focus on primary users’ information needs, the description in management commentary of an entity’s purpose needs to indicate how that purpose translates into creating value for the entity. The staff think that this

could be promoted by explaining an entity's business model by reference to creating value for the entity in pursuit of its purpose.

- (b) highlight the long-term aspect of the business model because, as mentioned in paragraph 25, the staff expect to describe purpose as the long-term component of an entity's strategy.

30. Therefore, the staff recommend that the revised Practice Statement should explain an entity's business model by reference to creating value for the entity in pursuit of the entity's purpose (see paragraph 40 for the staff's suggested illustrative drafting).

### ***Elements of the business model***

31. As mentioned in paragraph 7, some standard-setters describe business model or business in terms of its elements or components. The Board adopted a similar approach in IFRS 3 where it identified three elements of a business—inputs, processes and outputs.
32. Identifying the elements of a business model could encourage a structured approach to describing business model, in particular if the revised Practice Statement also specifies that all elements of an entity's business model should be described in management commentary. This may help address the gaps in reporting practice identified in the October 2019 Agenda Paper 15B, specifically that key features of business model are described in an overgeneralised way or not described at all.
33. Therefore, the staff recommend that the revised Practice Statement explains an entity's business model by reference to elements set out in IFRS 3—inputs, processes and outputs. The explanation will be based on the definition of a business in IFRS 3 and application guidance supporting that definition (see Appendix A). In explaining a business model the staff intend to capture the idea of a business model being an integrated set of processes that involves obtaining inputs and transforming them into outputs and generating cash flows for the entity by distributing those outputs or in other ways (see paragraph 40 for the staff's suggested illustrative drafting). The staff will provide recommendations for possible guidance on providing information about the elements of the business model in management commentary in a future paper.

***Note on terminology – ‘elements’***

- The staff note that both ‘elements’ and ‘components’ are used to discuss parts of an entity’s business model. The staff chose to use the term ‘elements’ for consistency with IFRS 3.

***Note on terminology ‘processes’***

- The staff note that some standard-setters use the terms ‘activities’ or ‘business activities’ to describe what how an entity transforms inputs into outputs. The staff chose to use the term ‘processes’ for consistency with IFRS 3 and to avoid confusion with instances when ‘business activities’ was used by the Board in a broader sense – for example, as noted in paragraph 6(b), in the *Conceptual Framework*.

***Impacts***

34. The operation of an entity’s business model can have indirect wider consequences or impacts, that do not, unlike outputs, translate into cash flows and value for the entity in the short term. Such impacts may affect the environment, the economy, particular groups of stakeholders or the society at large. In turn, the impacts on the environment, the economy or the stakeholders can affect the entity’s ability to generate cash flows in the medium or long term, and so, ultimately, affect the value created for the entity.
35. Although financial statements provide information about present assets, liabilities, income and expenses, management commentary has a more forward-looking nature. Accordingly, the staff recommend that the revised Practice Statement requires management to discuss in management commentary the impacts of the operation of the entity’s business model if those impacts could affect the entity’s ability to generate cash flows in the future. The staff will provide recommendations for guidance on discussing such impacts in management commentary in a future paper.
36. Some standard-setters identify impacts as an additional element of an entity’s business model. One example of this is the <IR> Framework, which identifies ‘outcomes’

alongside inputs, business activities and outputs. Outcomes are described as ‘the internal and external consequences (positive and negative) for the [six] capitals as a result of an organization’s business activities and outputs’.

37. While acknowledging the importance of providing guidance on discussing impacts in management commentary, the staff do not think that impacts should be specified as an additional element of a business model. Rather, the staff view impacts as indirect (and sometimes unintended) consequences of the operation of an entity’s business model.

***Note on terminology – ‘impacts’***

- The staff considered whether ‘impacts’ is the best label to use to describe the consequences of the entity’s operations other than producing outputs.
- As mentioned in paragraph 35, the <IR> Framework refers to ‘outcomes’. Some other standard-setters’ guidance, for example, the UK Financial Reporting Council’s *Guidance on the Strategic Report* and the EU Non-financial Reporting Directive (2014/95/EU), refer to ‘impacts’. The staff have heard that some stakeholders may associate ‘impacts’ mostly with environmental impacts.
- The term ‘impacts’ was used in discussions with the MCCG and was largely supported by its members. The staff think that using the term ‘impacts’ is consistent with the general meaning of the word (the definition in the Oxford dictionary is: impact – a marked effect or influence). However, the staff will continue looking for a better term without connotations inconsistent with how the Board uses the term.

***Business model being a matter of fact***

38. The staff note that in explaining the business model, IFRS 9 and the European Commission Guidelines on non-financial reporting state that an entity’s business model is a matter of fact.
39. The staff think that including a similar statement in the revised Practice Statement could be helpful because it would explain that the description of an entity’s business model should be factual – ie based on what the entity does during the reporting period and how it

does it. Any management's aspirations and intentions for developing an entity's business model based on the strategy need to be discussed in management commentary separately.

40. Accordingly, the staff recommend that the revised Practice Statement specifies that an entity's business model is a matter of fact and is observable through the entity's actions (see paragraph 40 for the staff's suggested illustrative drafting).

***Illustrative drafting for the explanation of an entity's business model***

41. In paragraphs 23, 29, 32 and 39 the staff recommend that the revised Practice Statement explains the meaning of an entity's business model by reference to:

- (a) value creation for the entity itself and clarifies that the notion of value created for the entity is related to the entity's ability to generate cash flows and can be affected by value created or destroyed by the entity for those parties with which the entity has relationships that the entity depends on for its success;
- (b) the entity's purpose that the entity's business model seeks to achieve;
- (c) elements set out in IFRS 3; and
- (d) business model being a matter of fact and observable through the entity's actions.

42. To illustrate how this can be implemented in the revised Practice Statement, the staff suggest the following initial draft explanation of the business model that would be provided at the beginning of the guidance on the business model content element and supported by further guidance that will be discussed in a future paper:

*A business model of an entity is an integrated set of processes that:*

- (a) *involves obtaining inputs, transforming inputs into outputs and generating cash flows for the entity by distributing those outputs to customers or in other ways; and*
- (b) *seeks to create value for the entity in pursuit of its purpose. An entity creates or maintains value by enhancing or maintaining its ability to generate cash flows. An entity's ability to generate cash flows can be affected by value created or*

*destroyed by the entity for other parties if an entity depends on relationships with those parties for its future success.*

*An entity's business model is a matter of fact and is observable through the entity's actions.*

**Question 1 for the Board**

The staff recommend that the revised Practice Statement explains the meaning of an entity's business model by reference to:

- (a) value creation for the entity itself and clarifies that the notion of value created for the entity is related to the entity's ability to generate cash flows. The explanation would indicate that value created for the entity can be affected by value created or destroyed by the entity for those parties with which the entity has relationships that the entity depends on for its success;
- (b) the entity's purpose that the entity's business model seeks to achieve;
- (c) the elements set out in IFRS 3—inputs, processes and outputs; and
- (b) business model being a matter of fact and observable through the entity's actions.

Do you agree with these recommendations?

**Question 2 for the Board**

The staff recommend that the revised Practice Statement requires management to discuss the impacts of the operation of the entity's business model if those impacts could affect the entity's ability to generate cash flows in the future.

Do you agree with this recommendation?

## Appendix A—Extracts from the Board’s guidance on business model

### ***Practice Statement 1 Management Commentary***

#### **Nature of the business**

- 26 Management should provide a description of the business to help users of the financial reports to gain an understanding of the entity and of the external environment in which it operates. That information serves as a starting point for assessing and understanding an entity’s performance, strategic options and prospects. Depending on the nature of the business, management commentary may include an integrated discussion of the following types of information:
- (a) the industries in which the entity operates;
  - (b) the entity’s main markets and competitive position within those markets;
  - (c) significant features of the legal, regulatory and macro-economic environments that influence the entity and the markets in which the entity operates;
  - (d) the entity’s main products, services, business processes and distribution methods; and
  - (e) the entity’s structure and how it creates value.

### ***Conceptual Framework for Financial Reporting***

#### **Contribution to future cash flows**

6.54 As noted in paragraph 1.4, some economic resources produce cash flows directly; in other cases, economic resources are used in combination to produce cash flows indirectly. How economic resources are used, and hence how assets and liabilities produce cash flows, depends in part on the nature of the business activities conducted by the entity.

### ***Basis for Conclusions on the Conceptual Framework for Financial Reporting***

#### **Business activities**

BC0.29 In developing the 2018 *Conceptual Framework*, the Board concluded that the nature of an entity’s business activities can affect the relevance of some types of financial information and that the Board may need to consider that factor when developing or revising Standards.

BC0.30 The Board disagreed with the view expressed by some stakeholders that considering the nature of an entity’s business activities necessarily leads to subjectivity and impairs comparability of financial statements. An entity’s business activities are a matter of fact that can in most cases be determined objectively. Hence, if entities conduct the same type of business activities, the Board expects that those activities would be reflected in a similar manner in the entities’ financial statements.

BC0.31 The Board considered whether the nature of business activities should be considered in all areas of standard-setting and should be embedded in the *Conceptual Framework* as an overarching concept. The Board concluded that the nature of an entity’s business activities does not affect all areas of financial reporting in the same way and to the same extent and so it should not be included as an overarching concept. Accordingly, the 2018 *Conceptual Framework* does not include a general discussion of how an entity’s business activities affect financial reporting decisions. Instead, the 2018 *Conceptual Framework* describes that factor in the context of:

- (a) the selection of the unit of account (see paragraph 4.51(a)(iv)).
- (b) the selection of a measurement basis for an asset or liability and for related income and expenses (see paragraphs 6.54–6.57). In some cases, this would lead to some items of income or expenses being included in other comprehensive income (see the discussion of more than one measurement basis in paragraphs 6.83–6.86).
- (c) classification of assets, liabilities, equity, income or expenses (see paragraph 7.7).

BC0.32 The concept of business activities is discussed in the 2018 *Conceptual Framework* to assist the Board in developing Standards. In a particular Standard, the concept of business activities can be further explained and developed. The discussion of business model in IFRS 9 *Financial Instruments* is one example of how the Board has applied the concept of business activities.

BC0.33 The Board decided to use the term ‘business activities’ rather than the term ‘business model’ in the 2018 *Conceptual Framework*. The term ‘business model’ is used with a range of different meanings by various organisations, for example, the International Integrated Reporting Council, the Enhanced Disclosure Task Force of the Financial Stability Board and various regulators. Adopting the term ‘business model’ in the 2018 *Conceptual Framework* could have led to confusion with those definitions.

## **IFRS 3 Business Combinations**

### **Appendix A**

#### **Defined terms**

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<b>business</b>	An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.
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### **Appendix B**

#### **Application guidance**

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**Definition of a business (application of paragraph 3)**

B7 A [business](#) consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. The three elements of a business are defined as follows (see paragraphs B8–B12D for guidance on the elements of a business):

- (a) **Input:** Any economic resource that creates outputs, or has the ability to contribute to the creation of outputs when one or more processes are applied to it. Examples include non-current assets (including [intangible assets](#) or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.
- (b) **Process:** Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates outputs or has the ability to contribute to the creation of outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but the intellectual capacity of an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)
- (c) **Output:** The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.

**IFRS 9 Financial Instruments**

**The entity’s business model for managing financial assets**

B4.1.1 Paragraph 4.1.1(a) requires an entity to classify financial assets on the basis of the entity’s business model for managing the financial assets, unless paragraph 4.1.5 applies. An entity assesses whether its financial assets meet the condition in paragraph 4.1.2(a) or the condition in paragraph 4.1.2A(a) on the basis of the business model as determined by the entity’s key management personnel (as defined in IAS 24 *Related Party Disclosures*).

B4.1.2 An entity's business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. The entity's business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. However, a single entity may have more than one business model for managing its financial instruments. Consequently, classification need not be determined at the reporting entity level. For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realise fair value changes. Similarly, in some circumstances, it may be appropriate to separate a portfolio of financial assets into subportfolios in order to reflect the level at which an entity manages those financial assets. For example, that may be the case if an entity originates or purchases a portfolio of mortgage loans and manages some of the loans with an objective of collecting contractual cash flows and manages the other loans with an objective of selling them.

B4.1.2A An entity's business model refers to how an entity manages its financial assets in order to generate cash flows. That is, the entity's business model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both. Consequently, this assessment is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called 'worst case' or 'stress case' scenarios. For example, if an entity expects that it will sell a particular portfolio of financial assets only in a stress case scenario, that scenario would not affect the entity's assessment of the business model for those assets if the entity reasonably expects that such a scenario will not occur. If cash flows are realised in a way that is different from the entity's expectations at the date that the entity assessed the business model (for example, if the entity sells more or fewer financial assets than it expected when it classified the assets), that does not give rise to a prior period error in the entity's financial statements (see IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) nor does it change the classification of the remaining financial assets held in that business model (ie those assets that the entity recognised in prior periods and still holds) as long as the entity considered all relevant information that was available at the time that it made the business model assessment. However, when an entity assesses the business model for newly originated or newly purchased financial assets, it must consider information about how cash flows were realised in the past, along with all other relevant information.

B4.1.2B An entity's business model for managing financial assets is a matter of fact and not merely an assertion. It is typically observable through the activities that the entity undertakes to achieve the objective of the business model. An entity will need to use judgement when it assesses its business model for managing financial assets and that assessment is not determined by a single factor or activity. Instead, the entity must consider all relevant evidence that is available at the date of the assessment. Such relevant evidence includes, but is not limited to:

- (a) how the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- (b) the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which those risks are managed; and
- (c) how managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected).

**Appendix B—How other standard-setters explain what business model is**

The staff’s review covered responses from 24 national standard-setters to the staff’s request for information about the requirements and commonly applied non-mandatory guidance on management commentary in their jurisdiction.<sup>5</sup> The staff also reviewed the EU Non-financial Reporting Directive (2014/95/EU) and the related European Commission Guidelines on non-financial reporting, and the International Integrated Reporting <IR> Framework because some of the respondent jurisdictions either require or encourage management to use them in preparing management commentary. In addition, the staff reviewed guidance issued by the participants in the Corporate Reporting Dialogue that was set up to promote greater coherence, consistency and comparability between corporate reporting frameworks, standards and related requirements.

The table below includes the extracts from those standard-setters’ guidelines and requirements that explain what an entity’s business model is.

<b>Guidelines or requirements</b>	<b>Extract</b>	<b>Includes references to</b>
EC Guidelines on non-financial reporting	<p>4.1 A company's business model describes how it generates and preserves value through its products or services over the longer term. The business model provides context for the management report as a whole. It provides an overview of how a company operates and the rationale of its structure, by describing how it transforms inputs into outputs through its business activities. In more simple terms, what a company does, how and why it does it.</p> <p>... A business model is a matter-of-fact case. Companies should avoid immaterial disclosures of promotional</p>	<ul style="list-style-type: none"> <li>• Value creation</li> <li>• Elements of business model (inputs, business activities, outputs)</li> <li>• Matter-of-fact</li> </ul>

<sup>5</sup> See Appendix A of November 2018 Agenda Paper 15B *Summary of research on the objective of management commentary* for details of the respondents and the survey questions.

	or aspirational nature which distract attention from material information.	
[UK] FRC Guidance on the Strategic Report	<p>7A.7 ...The disclosure of an entity’s purpose, strategy, objectives and business model should together explain what an entity does and how and why it does it. [...]</p> <p>7A.15 The description of the entity’s business model should explain how it generates and preserves value over the longer term. The business model should be consistent with the entity’s purpose.</p>	<ul style="list-style-type: none"> <li>• Value creation</li> <li>• The entity’s purpose</li> </ul>
International Integrated Reporting <IR> Framework	<p>4.11 An organization’s business model is its 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.</p>	<ul style="list-style-type: none"> <li>• Value creation</li> <li>• The entity’s purpose</li> <li>• Elements of business model (inputs, business activities, outputs and outcomes)</li> </ul>
ASIC (Australian Securities and Investments Commission) Regulatory Guide 247 <i>Effective disclosure in an operating and financial review</i>	<p>RG247.42 An informed understanding of an entity’s operations should generally be presented in the context of the entity’s business model, and this model should be clearly articulated. This includes explaining the key features of the business model—that is, how the entity makes money and generates income or capital growth for shareholders, or otherwise achieves its objectives.</p>	<ul style="list-style-type: none"> <li>• How the entity makes money</li> <li>• The entity’s purpose</li> </ul>