IFRS

STAFF PAPER

April 2020

IASB® meeting

Project	**Management Commentary**
Paper topic	Business model

CONTACT[S]	Jelena Voilo	jvoilo@ifrs.org	+44 (0)20 7246 6914
	Yulia Feygina	yfeygina@ifrs.org	+44 (0)20 7332 2743

Purpose of this paper

1. The purpose of this paper is to discuss what guidance should be included in the revised IFRS Practice Statement 1 *Management Commentary* (Practice Statement) on business model. In particular, this paper discusses:
   (a) the disclosure objective for business model; and
   (b) possible guidance supporting that disclosure objective.
2. This paper asks the Board for decisions on:
   (a) the disclosure objective for business model; and
   (b) identifying the key features of the entity's business model that would need to be addressed in management commentary. The paper does not ask the Board for decisions on other aspects of the supporting guidance but invites comments from the Board. The staff will consider those comments and will either address them in drafting the document or will present to the Board further analysis at a future meeting.
3. This paper builds on October 2019 Agenda Paper 15B *Introduction to business model* and November 2019 Agenda Paper 15A *What an entity's business model is* (see paragraphs 6–9).

Structure of this paper

4. This paper is structured as follows:

   (a) summary of staff recommendations (paragraph 5);

   (b) recap of the Board's previous discussions on business model (paragraphs 6–9);

   (c) summary of staff's research on business model (paragraphs 10–16);

   (d) disclosure objective for business model, including:

      (i) the headline objective (paragraphs 22–30);

      (ii) main assessments typically made by investors and creditors (paragraphs 31–37);

      (iii) types of information that needs to be provided (paragraphs 38–44);

   (e) possible guidance supporting the disclosure objective, including:

      (i) how to identify key features of the entity's business model (paragraphs 49–53);

      (ii) what information to provide about the entity's business model (paragraphs 54–68);

   (f) Appendix A—Extract from Practice Statement 1 *Management Commentary* on business model; and

   (g) Appendix B—Summary of feedback on business model received from the Management Commentary Consultative Group.

Summary of staff recommendations

5. The staff recommend that the revised Practice Statement:

   (a) specifies the disclosure objective for business model as follows:

   Management commentary shall provide information and analysis to help investors and creditors understand how the entity's business model creates value and converts that value into cash flows.

   That information and analysis helps investors and creditors assess:

(i) how effective the entity's business model is in creating value and converting it into cash flows;

(ii) how scalable the entity's business model is; and

(iii) how durable, resilient and adaptable the entity's business model is.

That information and analysis shall cover:

(i) the range, nature and scale of the entity's operations;

(ii) the entity's cycle for creating value and generating cash flows; and

(iii) the impacts of the entity's operations that could affect the entity's ability to generate cash flows.

That information and analysis shall focus on the key features of the entity's business model.

(b) specifies that the key features of the entity's business model are those that underpin the entity's ability to create value and generate cash flows.

Recap of the Board's previous discussions on business model

6. At the October 2019 meeting, the staff presented the findings of their research and outreach on business model, which included:

(a) review of recent publications on business model reporting;

(b) review of guidance on business model provided by other standard-setters; and

(c) discussions with the Board's consultative groups—Management Commentary Consultative Group (MCCG), Capital Markets Advisory Committee (CMAC) and Global Preparers' Forum (GPF).

7. The findings that are relevant for developing disclosure objective and supporting guidance on business model are summarised in paragraphs 10–16.

8. In November 2019, the Board discussed how to explain in the revised Practice Statements what an entity's business model is. The Board tentatively decided that the Practice Statement should, in explaining 'business model', refer to:

(a) value the entity creates for itself. The Practice Statement should also make clear that the notion of value created for an entity is related to the entity's ability to generate cash flows.

(b) the link between the entity's business model and the entity's stated purpose.

(c) the elements of the business model—that is, its inputs, processes and outputs.

(d) a business model being a matter of fact and observable through an entity's actions.

9. The Board also tentatively decided that the Practice Statement should require an entity's management to discuss indirect wider consequences or 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.

Summary of staff's research on business model

10. The research indicated that investors want:[1]

(a) information that is sufficiently broad to give them an understanding of the business, including information about what the entity does, how it is structured and where it sits in the value chain; and

(b) enough detail to understand what makes an entity unique, what it depends on for its success and whether its business model is sustainable in the long-term. Such information includes information about:

(i) an entity's competitive advantage;

(ii) key inputs (assets and liabilities, relationships and resources) and how they are maintained or enhanced;

(iii) key revenue and profit drivers; and

(iv) value created for other stakeholders that supports economic value generation.

[1] See October 2016 report *Business model reporting* and the follow-up October 2018 report *Business model reporting; Risk and viability reporting – Where are we now?* published by the Financial Reporting Lab (Lab) set up by the UK Financial Reporting Council (FRC). A detailed list of 'investor wants' was also included in Appendix B of October 2019 Agenda Paper 15B.

11. The staff discussed with the Board's consultative groups which information is currently missing from narrative reports. The discussions indicated that some of the information mentioned in paragraph 10 is missing. In particular, CMAC and GPF members suggested that entities should provide better descriptions of how their business model generates returns by creating value.

12. Members of the MCCG indicated that the main gaps in reporting practice are that descriptions of business model lack detail and focus, and do not provide information that helps investors and creditors understand how sustainable the entity's business model is. Specifically, those gaps include:

    (a) key features of how the business operates are either not described or are described in terms that are too generic.

    (b) key drivers of the entity's success are not identified.

    (c) key resources or relationships, in particular those that the entity depends on for its long-term success, are not described.

    (d) the possible effects of the entity's operations on its key resources and relationships and the possible effects of environmental, social or governance matters on the entity's long-term success are not discussed sufficiently.

13. Appendix B summarises the feedback from members of the MCCG on the staff's initial ideas for guidance on business model and explains how the staff have considered the feedback in developing recommendations for this paper.

14. The staff also reviewed other standard-setters' guidance on the business model.[2] Staff's research found that standard-setters vary in how much guidance they provide on describing business model in narrative reports:

    (a) some do not specifically require a description of the entity's business model;

[2] 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. 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 a management commentary or a similar report.

(b) some require a description of the entity's business model, but leave it to management to determine what to include in that description; and

(c) some provide guidance on what types of information about business model management should consider including in management commentary.

15. Where standard-setters provide guidance on the types of information to include in the description of model, examples of disclosures for management to consider providing include:

(a) the entity's structure;

(b) the entity's most important operating segments;

(c) locations of the entity's operations;

(d) sources of value to the entity, being the entity's key resources and relationships that support the generation and preservation of value;

(e) the entity's activities;

(f) business processes or methods of production of goods and methods of provision of services;

(g) market(s) in which the entity operates and how the entity engages with those markets, including:

(i) main products and services;

(ii) customers and distribution methods;

(iii) what part of the value chain the entity operates in and

(iv) competitive position within the market(s);

(h) impacts of the entity's activities, other than products and services produced or provided by the entity;

(i) external factors influencing the business;

(j) the entity's dependence on foreign operations; and

(k) the extent to which the business is cyclical or seasonal.

16. In addition, many standard-setters emphasise the importance of the description of an entity's business model as a starting point for or a fundamental context for understanding management commentary and the related financial statements. Some require management to consider whether information about the entity's business model is linked to—or is consistent with—information provided in other parts of management commentary, for example, on strategy, operating environment and risks, or performance, position and progress.

Disclosure objective for business model

17. As explained in Agenda Paper 15A *Introduction to disclosure objectives,* the disclosure objectives for each area of content in management commentary are intended to support all the 'pillars' of the overall objective of management commentary, that is to provide information to help investors and creditors:

    (a) assess the entity's prospects for future cash flows;

    (b) assess management's stewardship of the entity's economic resources;

    (c) better understand the entity's performance and position as depicted in the related financial statements; and

    (d) gain insight into factors that could affect the entity's prospects.

18. The existing Practice Statement states that the description of the entity's business in management commentary should 'help users of the financial reports gain an understanding of the entity and of the external environment in which it operates'. This statement can be understood as a broad disclosure objective. However, it may not be sufficiently prominent or specific to help preparers identify information needed to meet this implied objective.

19. The existing disclosure objective also covers operating environment. However, in developing recommendations for the revised Practice Statement the staff have focussed the description of the entity's business model on the substance of what the entity does and how it does it. The staff will provide recommendations on describing the entity's operating environment, including the disclosure objective for this area of content, in a future paper.

20. In developing recommendations for the disclosure objective on business model the staff followed the design described in Agenda Paper 15A. As explained in that paper, the staff think that it would be useful to provide a comprehensive disclosure objective that comprises a principle as the headline objective, a description of the assessments that investors and creditors typically make and a description of the types of information and analysis that need to be provided to support those assessment. Providing each of those components would:

    (a) help management identify information and analysis that need to be included in management commentary to meet the information needs of investors and creditors; and

    (b) help assurers and regulators assess whether information and analysis included in management commentary meet the overall objective of management commentary.

21. Furthermore, providing such a comprehensive disclosure objective would be consistent with the approach developed in the Disclosure Initiative—Targeted Standards-level Review of Disclosures.

The headline objective

22. In developing the disclosure objective for business model, the staff considered what investors and creditors need to understand about the entity's business model to help them make their assessments of the entity's prospects for future cash flows and of management's stewardship of the entity's economic resources.

23. The staff understand that many people use the term 'business model' as a concise and imprecise label for what an entity does and how it does it. Discussions with the Board's consultative groups as well as the staff's review of guidance provided by other standard-setters and recent publications suggest that business model is often used in discussing how and entity creates value or with how it makes money or generates revenues or returns. Different stakeholders place different emphasis on value creation and on generating cash flows. Some stakeholders prefer the term 'value creation' because they perceive it as better conveying a long-term view. Others, including some investors and creditors, prefer

the term ‘cash flow generation’ because they perceive references to value as vague and uninformative. Those investors and creditors point out that monetisation of value is important to them.

24. As explained in November 2019 Agenda Paper 15A and March 2020 Agenda Paper 15A *The objective of management commentary*, the notions of ‘value creation’ and ‘cash flow generation’ are closely related. This close relation is already reflected the Board’s tentative decision in November 2019 to refer in describing business model to value the entity creates for itself and to make it clear that the notion of value created for an entity is related to the entity’s ability to generate cash flows (see paragraph 8(a)). Furthermore, in March 2020 the Board broadly supported the staff’s proposed guidance on the overall objective of management commentary. In particular, that guidance explains that the notion of value that the entity creates for itself and its investors and creditors reflects the entity’s ability to generate positive net cash inflows after taking into consideration not only the amount of those cash flows but also their timing and uncertainty.

25. The staff think that it is important for investors and creditors to understand both how the entity’s business model creates value for itself and how it converts that value into cash flows. In discussing the staff’s initial ideas for disclosure objectives at the March 2020 CMAC meeting, some CMAC members highlighted that although it is important for them to understand how the entity creates value, it is even more important for them to understand how that value is monetised and see that value reflected in the financial statements as revenue and cash flows. They further argued that the link to cash flows is important because an entity cannot survive without generating sufficient cash flows.

26. On the basis of the research and outreach with stakeholders summarised in paragraphs 23–25, the staff think that referring in the disclosure objective for business model to **both** value creation and an entity’s ability to generate cash flows would:

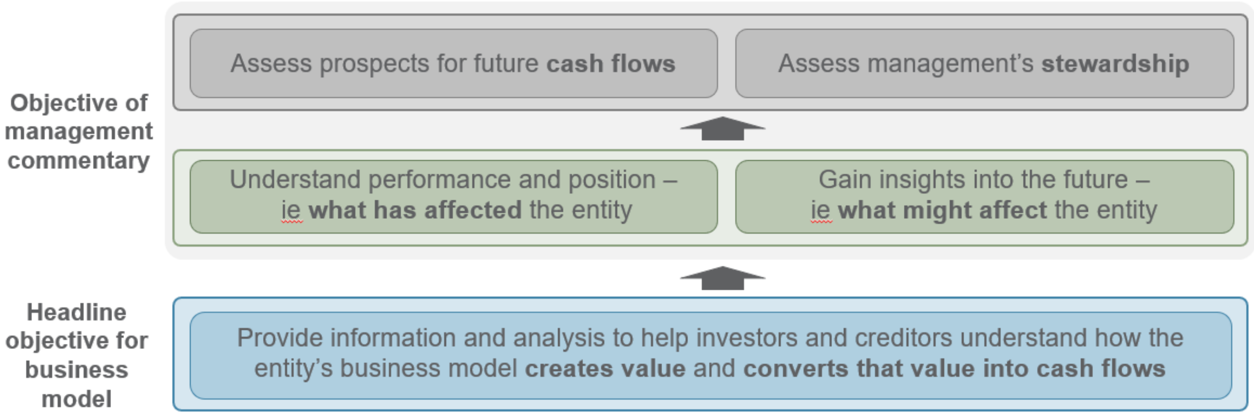
(a) emphasise the need for a long-term view in discussing factors underlying the entity’s prospects; and

(b) provide a clear link to the financial statements that reflect revenues and cash flows resulting from the operation of the entity’s business model.

27. Information and analysis that provide insights into the entity's prospects, including over a long term, and enhance understanding of the entity's performance and position depicted in the related financial statements would help investors and creditors assess the entity's prospects for future cash flows and management's stewardship of the entity's economic resources.

28. The relationship between the headline disclosure objective for business model and the overall objective of management commentary is illustrated in Figure 1.

Figure 1



29. The staff considered whether the disclosure objective for business model should also refer to maintaining or perhaps even destroying value and concluded that it should not. This is because the idea of creating value would also capture maintaining the same level of created value and destroying value is not something an entity's business model is designed to do. A few CMAC members were also concerned about having references to 'destroying value' in the headline objective. In addition, as explained in paragraph 9, the Board tentatively decided that the 'unintended' wider consequences of the entity's operations, such as destroying value, would be captured and discussed in management commentary under 'impacts' (see paragraphs 66–68).

30. For the reasons explained in paragraphs 23–29, the staff recommend that the headline disclosure objective for business model should be to provide information and analysis to

help investors and creditors understand how the entity's business model creates value and converts that value into cash flows.

> ***Note on terminology – 'value creation'***
>
> - The Board's November 2019 tentative decision refers to 'creating value for the entity'. The staff think that including 'for the entity' is not needed within the discussion of the disclosure objective for business model. The recommendation on the headline objective refers to both value creation and converting that value into cash flows, so the staff think there is no risk of misinterpretation what is meant by value in this context.

Main assessments typically made by investors and creditors

31. As explained in Agenda Paper 15A, the staff's proposed design of the disclosure objectives includes supporting the main principle stated in the headline objective by a description of the main assessments that investors and creditors typically make using the information in that area of content. This is intended to help preparers identify information they need to provide to investors and creditors for a particular area of content.

32. As illustrated in Figure 1, investors and creditors will ultimately use information and analysis about how an entity creates value and converts it into cash flows in their assessments of the entity's prospects for future cash flows and of management's stewardship of the entity's economic resources.

33. To make those assessments, investors and creditors need to assess, among other things, the entity's business model, in particular:

    (a) how 'good' the entity's business model is as it stands at the reporting date (see paragraph 34);

    (b) whether it has the potential to grow (see paragraphs 35); and

    (c) whether it is sustainable (see paragraphs 36).

34. As noted in paragraph 10(a), the staff's research indicates that investors and creditors want to understand what makes the entity unique and what it depends on for success. In discussing the staff's initial ideas about the disclosure objective for business model, CMAC members also indicated that information about the features of the entity's business model that give the entity competitive advantage or contribute to the entity's unique value proposition is important to them. Accordingly, the staff think that the disclosure objective for business model should explain that investors and creditors use information about the entity's business model to assess whether the business model is effective in creating value, in particular relative to the entity's peers, and whether it is successful in converting that value into revenues and cash flows reflected in the financial statements.

35. Feedback from the CMAC also suggested that investors and creditors assess whether the entity's business model has the potential to grow—whether it has reached its full potential or whether it can be scaled up. Scalability would provide a source of further value creation and a greater potential for generating cash flows. The assessment of the scalability of the entity's business model would provide investors and creditors with an insight into the entity's prospects.

36. As noted in paragraphs 10 and 12, assessing whether and entity's business model is sustainable is another important consideration for investors and creditors. However, the staff are aware that the term 'sustainability' can be interpreted differently by different parties and hence lacks clarity. Accordingly, the staff think that the disclosure objective for business model should not use the term 'sustainability' but should instead refer to specific aspects of sustainability that are important for investors and creditors' assessments of the entity's prospects for future cash flows and of management's stewardship of the entity's economic resources. Specifically, the staff think that the disclosure objective should capture the idea of a 'sustainable business model' as a business model that can continue creating value and generating cash flows both in normal circumstances and when circumstances change. To achieve that, the staff suggest focusing on the following facets of sustainability:

(a) durability—to reflect the business model's ability to remain functional over a long term if there are not significant changes in the entity's operating environment;

(b) resilience—to reflect the business model's ability to withstand or recover quickly from shocks or difficult conditions (for example, a significant temporary fall in demand for the entity's products due to a recession); and

(c) adaptability—to reflect the business model's ability to change in response to new circumstances (for example, an alternative product launched by a competitor or evolution of customer needs).

37. On the basis of the analysis in paragraphs 34–36, the staff recommend that the revised Practice Statement identifies the following main assessments that investors and creditors typically make about an entity's business model:

(a) how effective the entity's business model is in creating value and converting it into cash flows;

(b) how scalable the entity's business model is; and

(c) how durable, resilient and adaptable the entity's business model is.

Link to other areas of content

- As explained in paragraph 11 of Agenda Paper 15A, information provided on an area of content without information in other areas of content of management commentary may not be sufficient to help investors and creditors make their assessments. To assess durability, resilience and adaptability of the entity's business model investors and creditors will need other information, including information about the entity's resources and relationships, operating environment and risks the entity is facing.

Types of information that needs to be provided

38. On the basis of the research into investors and creditors' information needs and into guidance provided by other standard-setters, the staff have considered the main types of information and analysis that investors and creditors would need for their assessments described in paragraph 37:

(a) as noted in paragraph 10, investors and creditors want to understand in broad terms 'what the entity does'. To help achieve that, the staff think that preparers should be required to describe the range, nature and scale of the entity's operations. Other standard-setters' guidance also includes references to this type of information (see paragraphs 15(a)–15(c)).

(b) as noted in paragraphs 10–11, investors and creditors want to understand 'how the entity does it' and how the results of those operations are reflected in the entity's financial statements. To help achieve that, the staff think that preparers should be required to describe the entity's cycle for creating value and generating cash flows—from sourcing inputs to delivering outputs to customers. That cycle would cover the components of the entity's business model tentatively confirmed by the Board in November 2019—that is inputs, processes and outputs. Other standard-setters also commonly ask for information about the entity's activities or business processes (see paragraphs 15(d)–15(f)).

Note on next steps – financing and investing activities and taxation

- In the outreach performed, the staff heard that for their assessments investors and creditors need information not only about the entity's operating cycle, but also about the entity's financing and investing activities and taxation. The staff will provide recommendations on how such information should be provided in management commentary in a future paper.

(c) as noted in paragraph 12, investors and creditors want to understand possible effects of the entity's operations other than outputs. Other standard-setters' guidance also asks to preparers to provide such information (see paragraph 15(h)). The Board discussed this topic in November 2019 and tentatively decided that the description of the business model would need to explain those wider impacts of the entity's operations which may affect the entity's ability to generate cash flows in the future.

39. Table 1 explains how the guidance in the existing Practice Statement on the main types of information about an entity's business model aligns with the staff recommendation.

Table 1.

<table>
<tr><th>Guidance in the existing Practice Statement</th><th>How it aligns with the staff's recommendation</th></tr>
<tr><td>the industries in which the entity operates</td><td rowspan="3">Investors and creditors need to understand the environment in which the entity operates. However, in developing guidance for the revised Practice Statement the staff have focussed the description of the entity's business model on the substance of what the entity does and how it does it. The staff will provide recommendations on describing the entity's operating environment in a future paper.</td></tr>
<tr><td>the entity's main markets and competitive position within those markets</td></tr>
<tr><td>significant features of the legal, regulatory and macro-economic environments that influence the entity and the markets in which the entity operates</td></tr>
<tr><td>the entity's main products, services, business processes and distribution methods</td><td>As explained in paragraph 38(b), the staff think that management commentary should explain how the entity creates value from sourcing inputs to delivering outputs and converting them into cash flows. The existing Practice Statement does not explicitly mention inputs in the guidance on describing the nature of business activities—instead it provides guidance on describing resources and relationships separately (see Agenda Paper 15D).</td></tr>
</table>

	Distribution methods are expected to be covered in the guidance on outputs (see paragraph 65).
the entity's structure and how it creates value	The entity's structure is expected to be covered as part of explaining the range, nature and scale of the entity's operations (see paragraph 54). The staff proposes to specify that the description of how the entity creates value should cover the whole cycle of value creation and cash flow generation (see above).

40. As stated in paragraph 12, one of the main existing gaps in reporting practice identified by the staff is that entities' business model descriptions are often generic and lack focus on features important for those entities. Therefore, the staff think that it would be helpful to require as part of the disclosure objective that information and analysis on the entity's business model should focus on the key features of the entity's business model.

41. The staff note that the existing Practice Statement also refers to describing 'main markets' and 'main products, services, business processes and distribution methods'. However, the Practice Statement does not include guidance on how to identify those 'main' features nor does it explain what information about them to provide. The staff considered how to help preparers identify:

(a) 'key' features of the entity's business model (see paragraphs 49–53); and

(b) information and analysis that might need to be provided about those features for each type of information identified in the disclosure objective (see paragraphs 54–68).

Note on terminology – 'key'

- The existing Practice Statement users the terms 'main', 'critical', 'significant', 'most important', principal' to refer to items that need to be described in management commentary in various areas of content. The staff uses the term 'key' to consistently refer to all such items. The staff will consider in drafting whether this is the most appropriate label for this notion.

42. Finally, the staff's research indicated that other standard-setters as well as investors and creditors highlight the importance of the description of business model as a context for other information provided in management commentary and in the related financial statements, for example, for understanding the entity's strategy or its performance, position and progress. The staff think that the revised Practice Statement should also highlight the role of the description of the entity's business model as a context for other information in management commentary and in the related financial statements. However, the staff do not think that this observation belongs to the disclosure objective for business model.

43. To conclude, the staff recommend that the revised Practice Statement requires that the information and analysis on business model in management commentary cover the following types of information:

    (a) the range, nature and scale of the entity's operations;

    (b) the entity's cycle for creating value and generating cash flows—from sourcing inputs to delivering outputs to customers; and

    (c) the impacts of the operation of the entity's business model that could affect the entity's ability to generate cash flows in the future.

44. The staff further recommend that the revised Practice Statement specifies that information and analysis set out in paragraph 43 should focus on the key features of the entity's business model.

Question 1 for the Board

The staff recommend that the revised Practice Statement specifies the disclosure objective for business model as follows:

(a) management commentary should provide information and analysis to help investors and creditors understand how the entity's business model creates value and converts that value into cash flows.

(b) that information and analysis helps investors and creditors assess:

(i) how effective the entity's business model is in creating value and converting it into cash flows;

(ii) how scalable the entity's business model is; and

(iii) how durable, resilient and adaptable the entity's business model is.

(c) that information and analysis should cover:

(i) the range, nature and scale of the entity's operations;

(ii) the entity's cycle for creating value and generating cash flows; and

(iii) the impacts of the entity's operations that could affect the entity's ability to generate cash flows.

That information and analysis should focus on the key features of the entity's business model.

Do you agree with these recommendations?

Possible guidance supporting the disclosure objective

45. As explained in Agenda Paper 15A, the disclosure objective is intended to help management identify information and analysis that needs to be included in management commentary to meet investors' and creditors' information needs. Entities that apply the Practice Statement must comply with all aspects of disclosure objectives.

46. To help preparers apply the disclosure objective for business model recommended above, the staff considered what supporting guidance could be included in the revised Practice Statement on:

(a) identifying 'key' features of the entity's business model (paragraphs 49–53); and

(b) information that might be provided for each type of information identified in the disclosure objective:

(i) the range, nature and scale of the entity's operations (paragraphs 54–55);

(ii) the entity's cycle for creating value and generating cash flows (paragraphs 56–65); and

(iii) impacts of the entity's operations (paragraphs 66–68).

47. The supporting guidance will discuss what information entities should consider including in management commentary in order to meet the disclosure objectives and when and how that information should be provided.

48. In developing that supporting guidance, the staff considered the guidance included in the existing Practice Statement, the guidance published by other standard-setters, the gaps in practice and information needs of investors and creditors identified by the staff and the feedback received in outreach activities. As previously discussed with the Board, the staff aim to develop supporting guidance that is principle-based but provides sufficient detail to support application of the revised Practice Statement and assurability of management commentaries.

How to identify key features of the entity's business model?

49. In July 2019, the Board tentatively approved guidance on making materiality judgements in preparing management commentary. Generally, information is considered material if it can reasonably be expected to affect investors and creditors' assessment of the prospects for future cash flows and of management's stewardship of the entity's economic resources.

50. That guidance applies to all information in management commentary. To help apply that guidance in identifying material information about an entity's business model, the staff suggest providing guidance on identifying 'key' features of the entity's business model, information about which is likely to be material to investors and creditors' assessments.

51. As discussed in paragraph 30, to make assessments of the entity's prospects for future cash flows and of management's stewardship, investors and creditors focus on understanding how the entity's business model creates value and converts that value into cash flows. It follows that the revised Practice Statement should apply the same principle to the identification of the 'key' features of the entity's business model and link it to the entity's ability to create value and generate cash flows. Accordingly, the staff recommend that the revised Practice Statement should describe the key features of the entity's business model as those that underpin the entity's ability to create value and generate cash flows.

52. Furthermore, the staff think that the revised Practice Statement could also provide guidance to help preparers identify those key features. Considering the main assessments that investors and creditors typically make about the entity's business model (discussed in paragraphs 31–37), the Practice Statement could include the following examples of key features of the entity's business model:

(a) features that underpin the entity's value proposition (such as a product intended to meet a specific need of a particular consumer category);

(b) features that provide an entity with a competitive advantage (such as know-how in a particular area);

(c) features that create uncertainty about the entity's ability to generate cash flows (such as an uncertainty over receiving a patent on a major new product developed by the entity); or

(d) features that need to change, or did change during the reporting period, and affect the entity's ability to generate cash flows (such as a process that needs to be changed to adhere to newly introduced environmental regulations or a new product designed over the reporting period that is expected to generate significantly higher revenue in the next period).

53. In some cases, various operations of an entity create value and generate cash flows differently (ie the entities can be seen as having more than one business model). The description of the entity's business model in management commentary may need to provide information about all those operations (see paragraph 55). In such cases, the entity would need to discuss the key features of each business model separately.

Note on next steps – sensitive information

- In the outreach performed, the staff heard a concern that information about key features of an entity's business model is commercially sensitive and that providing such information in management commentary may harm entities' competitive position. The staff note that this is a cross-cutting issue that may arise for various areas of content in management commentary. This issue also arises for some information required to be provided in financial statements. However, the staff acknowledge that this issue is more prevalent for management commentary and will consider whether the revised Practice Statement should provide guidance on sensitive information as the project progresses.

Question 2 for the Board
The staff recommend that the revised Practice Statement specifies that the key features of the entity's business model are those that underpin the entity's ability to create value and generate cash flows. Do you agree with this recommendation?

What information to provide about the entity's business model?

The range, nature and scale of the entity's operations

54. The staff have reviewed guidance provided by other standard-setters and analysed investors and creditors' information needs in considering guidance that could be included in the revised Practice Statement on describing the range, structure and scale of the entity's operations. That description may need to cover:

    (a) overview of the entity as a whole. In particular, if management commentary describes the entity's purpose, the overview of the business model could explain how the entity's business model relates to the entity's stated purpose. As noted in paragraph 8, the Board tentatively decided that the guidance on business model should refer to the link between the entity's business model and the entity's stated purpose. Explaining that link in management commentary could help investors and creditors understand how the entity's stated purpose is operationalised and how closely the entity's business model is aligned with that purpose. It could also give them an insight into how the entity's business model may change in the future in the light of the entity's purpose (Agenda Paper 15C

Strategy provides guidance on discussing the link between the entity's strategy and its purpose).

Note on terminology – 'purpose'

- The staff have used the term 'purpose' to refer to the entity's description of why the entity exists. Alternative terms that are used in practice to refer to a similar notion include 'vision' and 'mission'. 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.

(b) locations of the entity's operations. That information could help investors and creditors understand, for example, the dependency of the entity on foreign operations.

(c) the entity's operating structure. The feedback from investors and creditors indicates that the description of the entity's operating structure in management commentary must be reconcilable to operating segments disclosure in the entity's financial statements. Information about the entity's key operating segments might include information on:

(i) interrelationships between different segments of the entity; and

(ii) relative importance of those segments.

(d) the entity's legal structure if it is different from its operating structure and if information about the legal structure is important for understanding the entity's operations.

(e) significant changes in the range, nature or scale of the entity's operations over the reporting period, including those resulting from acquisitions and disposals, strategic partnerships or joint ventures.

55. In some cases an entity may run several distinct business models. The staff think that the Practice Statement could explain that in those cases the entity's management would need

to provide separate descriptions of the entity's business models, including separate explanations of their cycles for value creation and cash flow generation.

The entity's cycle for creating value and generating cash flows

56. The staff think that the guidance on explaining the entity's cycle for creating value and generating cash flows could be based on the components of the entity's business model tentatively confirmed by the Board in November 2019 (see paragraph 8) and so focus on how the entity transforms the inputs through processes into outputs and, ultimately, into cash flows for the entity.

Inputs

57. The revised Practice Statement could explain that the entity's business model relies on resources and relationships. Resources are used as inputs into the entity's business model. Relationships play an important role throughout the cycle of creating value and generating cash flows for the entity. For example, relationships with suppliers can affect the entity's access to resources used as inputs into the entity's processes, and relationships with customers can affect the entity's ability to distribute its products and to generate cash flows.

58. Agenda Paper 15D *Resources and relationships* discusses how to identify key resources and relationships and what information about them may need to be provided in management commentary and recommends that the revised Practice Statement requires entities to focus on resources and relationships that the entity's business model and strategy depend on. It also recommends that, in describing inputs into the entity's business model, management commentary should cover the nature of resources and relationships needed for the operation the entity's business model; the nature of the entity's access to those resources and relationships; how those resources and relationships are used, factors that may affect whether access to those resources and relationships will continue and how those resources and relationships are managed. That paper asks the Board for decisions on those topics.

59. As previously discussed with the Board, the structure of the revised Practice Statement is not intended to prescribe the structure of management commentary. Management would

need to determine how best to organise information in management commentary, including where to explain resources and relationships that the entity's business model depends on.

Processes

60. The revised Practice Statement could explain that processes are series of actions that transform inputs into outputs and distribute them to generate cash flows for the entity.

61. Key processes that might need to be described in management commentary will vary depending on the nature of the entity's operations. Examples of processes that may need to be discussed in management commentary include:

(a) research and development, highlighting the status of any products or services in development;

(b) product design;

(c) production, highlighting any developments such as expansion of production capacity or improvement in productivity;

(d) quality control;

(e) processes related to marketing and distribution of outputs; and

(f) after sales service.

62. Some key processes may also relate to maintaining or developing relationships that are key to the entity's business model, for example, staff training, in particular development of specialised skills needed to produce new products. As noted in paragraph 55, supporting guidance on describing how key resources and relationships are managed is discussed in Agenda Paper 15D.

63. The possible supporting guidance on describing an entity's business model, including describing processes, focuses on the business model at the reporting date and any significant changes since the last reporting period. Management objectives and plans for maintaining and developing the entity's business model in the future are covered by guidance on strategy (see Agenda Paper 15C *Strategy*).

Note on next steps – reporting date and reporting period

- The staff will provide recommendations on the reporting date of and reporting period covered by management commentary at a future meeting.

Outputs

64. The revised Practice Statement could describe outputs as the direct results of operating the entity's business model, ie products and services intended to create value and to generate cash flows for the entity. In some cases, the entity's operations may also produce by-products that may need to be described in management commentary.

65. The description of key outputs in management commentary may cover:

    (a) types of customers and markets, including the description of relationships with customers (guidance on describing the entity's key relationships is provided in Agenda Paper 15D);

    (b) the value proposition, that is how the entity's products or services are differentiated to meet the needs of customers; and

    (c) selling and distribution channels.

Impacts

66. The operation of an entity's business model can have indirect wider consequences or impacts, that do not, unlike outputs, necessarily have a direct effect on value for the entity and cash flows. 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 affect the value created for the entity.

67. In November 2018, the Board tentatively decided that the revised Practice Statement should require 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.

68. The revised Practice Statement could also explain that:

(a) impacts of the entity’s operations could affect affect the entity’s ability to generate cash flows if they affect the resources or relationships that the entity’s ability to generate cash flows depends on;

(b) the description of business model needs to cover both positive and negative impacts of the entity’s operations. For example, the entity may need to describe:

  (i) the entity’s impact on a country’s water supply if it operates in a country where water is scarce and if the entity’s business model or strategy depends on water in that country or on relationships that could be significantly damaged by those impacts; or

  (ii) the entity’s activities aimed at improving computer literacy in a particular region if the entity expects the positive impact of those activities to lead to more sales of the entity’s software in the region.

(c) management commentary may need to describe how key impacts of the entity’s activities are monitored and managed, including actions to maintain positive impacts and mitigate negative ones.

Link to other areas of content – performance, position and progress

Guidance on performance, position and progress:

- could include guidance on metrics and key performance indicators for measuring management’s progress in managing the impacts of the entity’s operations;
- could ask management to discuss expenses incurred during the reporting period on managing the impacts.

Question 3 for the Board
Paragraphs 45–68 provide staff’s discussion of the guidance supporting the disclosure objective for business model that could be included in the revised Practice Statement. Do you have any questions or comments on that discussion?

Appendix A—Extract from Practice Statement 1 *Management Commentary* on business model

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.

Appendix B—Summary of feedback on business model received from the Management Commentary Consultative Group (MCCG)

In April 2019, the MCCG discussed the staff's proposals on business model. The proposed approach included introduction of two components for the description of the business model—a discussion of the structure of the entity and a discussion of business activities covering inputs, including resources and relationships, processes and outputs and impacts. Please note that in the revised proposals the staff present recommendations for guidance on resources and relationships separately from guidance on business (see Agenda Paper 15C and Appendix B to that paper summarising the feedback received from the MCCG on resources and relationships). In addition, in December 2019, the MCCG discussed the link between business model and the entity's purpose.

The following table summarises the feedback received from members of the MCCG on the proposed guidance and explains how the feedback has been considered in the staff's revised proposals for guidance on business model.

Feedback	Staff's response
Mixed response to the proposal to link the provision of detailed information about specific features of the business model to the prospects for future net cash inflows: - some asked for clarity on time horizons; - some suggested a link to 'value creation' or 'value creation through cash flows' could be more appropriate.	In the revised proposals on business model the staff suggest including both the notion of value creation and the notion of cash flow generation to reflect that investors and creditors may be interested in both (see paragraphs 25–30). The revised Practice Statement is also expected to include an explanation of the link between the two notions.
A suggestion to explain the purpose as the reason for the entity's existence to make a natural link to business model because the description of business	The staff's proposals on how the entity may discuss the link between the entity's business model and its stated purpose reflect this suggestion (see paragraph 54(a)). The staff also note that overall, members agreed that the revised Practice Statement should allow entities to discuss their purpose, even if it is stated broadly with no connection to

model would then explain how the entity operationalises its purpose.	generating cash flows, because that would give investors and creditors insight into the entity. Members also agreed that a description of purpose should not be required from entities that do not have a stated purpose.
Concerns related to the proposed requirement to discuss how the entity's legal structure relates to the operating structure, including that it may lead to boilerplate disclosures. A member also said that the requirement to list the main subsidiaries under IAS 24 *Related Party Disclosures* addresses the need for information about legal structure.	In the revised proposals, the staff suggest that the revised Practice Statement could ask for a description of the entity's legal structure only if the entity's legal structure is different from its operating structure and if information about the legal structure is important for understanding the entity's operations (see paragraph 54).
A suggestion that information on segmental cash flows would be useful to users. However, a member with a preparer background noted that entities may not necessarily prepare this information for internal use.	As discussed in the March 2020 Agenda Paper 2020, management commentary should derive from information that is important to management in managing the business. It cannot be assumed that information about segmental cash flows is always available and important for the entity's management. Therefore, the staff think that the revised Practice Statement cannot require management commentary to provide information on segmental cash flows.
A suggestion to highlight in the revised Practice Statement that the description of the entity's operating structure should be aligned with segment disclosure in financial statements.	The staff suggest highlighting in the revised Practice Statement the need for the description of the entity's operating structure to be reconcilable with the description of the operating segments disclosed in the entity's financial statements (see paragraph 54).
A suggestion that the discussion of impacts in management commentary should be linked to the discussion of resources and relationships.	The staff suggest emphasising the link between the impact of the entity's operations and its resources and relationships in the supporting guidance on impacts (see paragraph 68).
Mixed views on whether the description of business model should focus on the changes in the entity	In March 2020 the Board tentatively decided to explain that investors and creditors (who are the primary users of management commentary) are expected to have a

business model(s) from the previous period, or also cover standing information about business model(s).	reasonable knowledge of business and economic activities and to review and analyse the information diligently, but are not expected to have knowledge of the entity. That would mean that management commentary would need to include standing information about the entity (including about its business model) in addition to information about what has happened or changed during the reporting period.
A suggestion to align some of the terminology in the staff's proposals with the terminology in the International Integrated Reporting <IR> Framework, for example to use the term 'outcomes' rather than 'impacts'.	Both the term 'impacts' and 'outcomes' are used in the narrative reporting field and both terms can be difficult to interpret. The staff will continue searching for the best term to use in the revised proposals.