

IASB Meeting

Project	Conceptual Framework		
Paper topic	The use of 'business model' in the Conceptual Framework		
CONTACT(S)	Li Li Lian	llian@ifrs.org	+44 20 7246 6486
	Rachel Knubley	rknubley@ifrs.org	+44 20 7246 6904
	Peter Clark	pclark@ifrs.org	+44 20 7246 6451

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

This paper is a very early draft of part of the Conceptual Framework discussion paper. It has been prepared by the staff for discussion by the IASB. Issues discussed and conclusions reached will be subject to change.

What is business model?¹

1. This paper discusses business model.
2. The following paragraphs:
 - (a) Describe the use of the business model concept in existing and proposed IFRSs (paragraphs 3-7);
 - (b) Explain how others have defined the term business model (paragraph 8);
 - (c) Discuss the advantages and disadvantages of using an entity's business model in financial reporting (paragraphs 9 and 10); and
 - (d) Describe how this discussion paper has used ideas similar to a business model concept (paragraphs 11 and 12).

¹ This agenda paper discussing business model is likely to be included in the introductory chapter of the Conceptual Framework discussion paper.

Use of ‘business model’ in IFRSs

3. The IASB first used the term ‘business model’ in IFRS 9 *Financial Instruments* - classification and measurement of financial assets depend on an entity’s business model for managing those assets.
4. IFRS 9 does not define an entity’s business model but notes the following factors in determining a business model:
 - (a) The entity’s key management personnel (as defined in IAS 24 *Related Party Disclosures*) are responsible for determining the objective of the business model.
 - (b) An entity’s business model is not a choice but rather it is a matter of fact that can be observed by the way an entity is managed and information is provided to its management.
 - (c) A single entity may have more than one business model for managing its financial instruments.
 - (d) A business model is different from ‘management’s intentions’, which can relate to a single instrument.
5. More recently, the IASB required investment entities not to consolidate their subsidiaries (IFRS 10 *Consolidated Financial Statements*). This is because investment entities have a unique business model that makes reporting subsidiaries at fair value more appropriate than consolidation².
6. Although other IFRSs do not explicitly refer to a business model, the way in which an entity uses its assets has previously been used by the IASB, particularly in classifying and measuring different types of non-financial assets:
 - (a) Inventories are assets that are held for sale in the ordinary course of business, in the process of production for such sales or in the form of materials or supplies to be consumed in the production process or in the rendering of services (IAS 2 *Inventories*).
 - (b) Inventories held by commodity broker-traders are measured differently from other inventories because they are acquired with the purpose of

² IFRS 10.BC226

selling in the near future and generating a profit from fluctuations in price or broker-traders' margin (IAS 2 paragraph 5).

- (c) Investment properties are used to earn rentals or for capital appreciation or both, rather than for (a) use in the production or supply of goods or services or for administrative purposes; or (b) sale in the ordinary course of business. (IAS 40 *Investment Property*).
- (d) Property, plant and equipment are held for use in the production or supply of goods or services or for administrative purposes. (IAS 16 *Property, Plant and Equipment*).
- (e) Non-current assets that will no longer be used by the entity (assets that are held for sale or are discontinued) are measured differently from other non-current assets (IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*).

7. An entity's business model also affects how it reports operating segments in accordance with IFRS 8 *Segment Reporting*. The management approach to segment reporting requires disclosure of information about operating segments that is based on the how the entity's chief operating decision maker decides about the resources to be allocated and assess its performance. The IASB noted that this approach would allow users to review an entity's operations from the same perspective as management³.

How others have described the term business model

8. Although some existing IFRSs reflect the way in which a reporting entity conducts its business activities, the IASB has not defined the term "business model". However, other organisations have described the business model concept as follows:
 - (a) Some have suggested the following definition for a business model: "the chosen system of inputs, business activities, outputs and outcomes that aims to create value over the short, medium and long term".

³ IFRS 8.BC10

- (b) Some think that a business model would reflect:
 - (i) the configuration of the business;
 - (ii) activities of the business,
 - (iii) how the business adds value including the generation of its cash flows, and
 - (iv) customers of the products or services.
- (c) Some think that the business model refers to management's use or disposition of assets and holding or transferring/settling obligations, with the understanding that these actions are undertaken with a profit motive. They are of the view there is no difference between management's intent and a business model approach.

Advantages and disadvantages of using an entity's business model in financial reporting

9. Some have argued that the business model concept should play a significant role in standard-setting. They think that applying the business model concept when developing IFRSs provides relevant information because it provides insights into how the entity's business activities are managed. Consequently, it helps users assess the resources of the entity, claims against the entity, and how the entity's management and governing board have discharged their responsibilities to use the entity's resources.
10. Others think that the business model should not be used in standard-setting because:
 - (a) they think it reduces comparability:
 - (i) Having a business model approach could result in different classification, measurement or disclosure of the same economic phenomenon or transaction. For example, identical financial assets could be accounted for differently depending upon whether the entity will hold the asset for collection or for sale.

- (ii) Some believe that business model approach to financial reporting provides entities with a choice about how to report the same economic phenomenon or transaction.
- (b) they think it could encourage less neutral reporting because it could encourage preparers to present the most favourable outcome.
- (c) they believe that the business model concept is difficult to define and apply on a consistent basis.

How this discussion paper has used ideas similar to a business model concept

11. This [draft] discussion paper does not define the business level concept. However as described above the IASB believes that financial statements can be made more relevant if the way in which an entity conducts its business activities is considered when developing new or revised IFRSs.
12. The way in which an entity conducts its business activities is considered in the following section of this [draft] discussion paper:
 - (a) Measurement (AP10F(a)): The measurement section proposes that the IASB should consider how an asset would be realised and a liability fulfilled when deciding on an appropriate measurement method.
 - (b) Other Comprehensive Income (OCI) (AP10H(a)): in deciding whether to present different measurement bases in the profit or loss and the statement of financial position (ie a bridging item), this [draft] discussion paper proposes that IASB should consider (amongst other things) how the entity intends to use that item in its business.
 - (c) Disclosure (APG(a)): In determining the level of aggregation or disaggregation in the primary financial statements, the IASB or an entity will need to consider the function of the item.

Question

Do you have any comments on the proposed discussion of the business model concept?