

Your reference:  
Our reference: 85/350

**MOORE STEPHENS**

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16 May 2014

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Dear Sir/Madam

### **THE ROLE OF THE BUSINESS MODEL IN FINANCIAL STATEMENTS**

Moore Stephens LLP is pleased to respond to EFRAG on their research paper, The Role of the Business Model in Financial Statements.

We consider that the research paper is a very useful contribution to the debate concerning the role that the business model should play in financial reporting. On balance, we prefer an approach under which the business model plays a restricted role, due to the concerns articulated within the paper in relation to consistency, comparability and objectivity. However, a restricted role does not mean no role, and we acknowledge that there are cases where the application of the business model is crucial in ensuring the appropriate classification and treatment of items.

Attached to this letter you will find Appendix 1 with our comments to the specific questions raised in the paper.

If you wish to discuss any matters raised in this letter then please contact David Chopping, Partner (+44 (0) 207 651 1050).

*Moore Stephens LLP*

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**Question 1 – Implicit Use of the Business Model**

(a)

We broadly agree with the analysis of the implicit examples from IFRS which involve the use of the business model.

(b)

We believe there are a number of other examples where IFRS implicitly uses a business model approach.

For example:

- the paper already notes that a tangible asset may fall within the scope of IAS 2 or IAS 16. This is not connected with the underlying asset but with the use to which that asset will be put within the business. We would note that the same can also apply to intangible assets, which might fall within the scope of IAS 2, IAS 11 or IAS 38, depending upon whether they will be recovered through sale or use;
- the identification of a financial asset as falling into the category of “held to maturity” under IAS 39 depends upon the entity’s business model. Notwithstanding the limitations placed upon the use of this category as a result of the “tainting” provisions, the definition contains both objective elements and elements that depend upon the intention of the entity. The requirements for fixed and determinable payments and a fixed maturity are objective, and would therefore apply equally to all holders of the particular instrument. The positive intention to hold to maturity depends upon the business model. The ability to hold to maturity is more complex, since this could be seen as a further objective element, however difficult this may be to determine, or as a restriction on the ability to implement the business model;
- more generally, the IAS 39 classifications of financial assets depend upon the business model within which the assets are held. Loans and receivables, again, contain objective elements but contain the converse of the trading designation and allow items to be designated as available for sale. The distinction between loans and receivables for a particular entity is therefore likely to reflect the business model of the entity holding the assets;
- IAS 12, and para. 51 in particular, requires deferred tax assets and liabilities to be measured based on the tax rules that would apply from the manner in which the entity expects, at the end of the reporting period, to recover the asset or settle the liability. This will depend upon the business model within which the asset or liability is held. Whilst para. 51C is given as an example of explicit use of business model in the paper we would note that this only made explicit what was already implicit in para. 51.

This, of course, raises the question of whether and to what extent the business model can be equated with management intent.

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**Question 2 – Cash Conversion**

(a)

Whilst we broadly agree with the analysis of the cash conversion cycle, the interaction between the stated elements means this is probably not as useful a tool as it could be. We believe it would benefit from a clearer focus on distinguishing elements of the cycle, and in particular a clearer distinction between those risks associated with time and other risks affecting cash flows.

(b)

We do not suggest the addition of further attributes.

**Question 3.1 – Banking**

(a)

We agree that these are different business models. Whilst initially loans may be created in the same manner there is a major difference in the use to which those assets are put and, in particular, in the ways in which they generate cash flows for the business.

(b)

We support view B.

Despite the difference in business models, we consider that using the same accounting treatment aids comparability, and that the differences should be reflected only where they give rise to different outcome, in this case the transfer or retention of the loans making up the initial portfolio. Whilst not asked, we also prefer statement at amortised cost.

(c)

No.

(This is consistent with view B)

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**Question 3.2 – Mobile Network**

(a)

We agree that these are different business models, since the cash inflows and outflows and the risks associated with those cash flows differ.

(b)

We support view B.

Again. Despite the difference in business models we do not consider it is useful or necessary to treat the transactions to which the entities are party differently, in principle.

Whilst A and B would clearly prepare financial statements that looked quite different, due to the different nature of the specific transactions they enter into, this is because their different business models give rise to separate transactions which can then be accounted for independently of the business model. Where there is common ground, as in the principle of whether an intangible asset has been created, then we see no justification for differential treatment.

(Note that we have not considered whether an intangible asset should be recorded.)

(c)

No

(Again, this is consistent with view B.)

**Question 3.3 – Insurance**

(a)

We agree that these are different business models due to the different bases of cash outflows.

(b)

We support view B. The assets are not affected by the liabilities and it is only the liability treatment that should differ.

(c)

No.

(Again, this is consistent with view B.)

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**Question 4 - Role**

The only additional comment we would make is that we would support an approach whereby the effect of the business model on financial statements is minimised.

In many cases, and consistent with our response to the questions above, we believe that the direct effect of the business model should not affect the financial statements, other than indirectly through its effect on the transactions into which the entity and the assets and liabilities to which it gives rise. Those transactions, assets and liabilities, should as far as possible be reported without reference to the business model. As noted in the paper, there are many other avenues that can be used for reporting of such information.

However, we consider that the effect of the business model cannot be ignored entirely. There are cases, such as the classification and treatment of tangible assets, where we consider that any model that attempted to ignore the business model would result in treatments that would not provide useful information to investors.

**Question 5 – Criteria**

(a)

We agree that criteria should be included.

(b)

We do not agree with the suggested criteria. Reflecting our comments above, we consider that the criteria should be limited to those cases where it provides a better reflection of the objective economics of transactions or balances.

(c)

We do not suggest any further criteria.

**Question 6 – Implications**

We have no further comments.