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EFRAG's Proactive Project: *The Role of the Business Model in Financial Statements*

EFRAG Board 16 December 2015

EFRAG's Proactive project: The Role of the Business Model in Financial Statements

- Initiated by EFRAG in partnership with the French and UK standard setters
- Aims to explore the implications of the business model for financial statements.
- Main output:
  - Research Paper *The role of the business model in financial statements* (December 2013)
- *To exercise timely influence, EFRAG and the 4 NSS publish a Bulletin:*
  - *The role of the business model in financial reporting* (June 2013)

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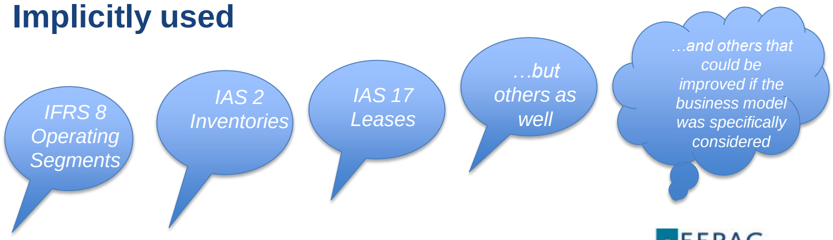
The Business Model Notion in IFRS

Explicitly used

- Explicitly introduced in IFRS in 2009 when the IASB issued IFRS 9 *Financial Instruments*
- Amendments to IAS 12 *Income Taxes* issued in 2010
- The special accounting by investment entities under IFRS 10 *Consolidated Financial Statements*

Implicitly used



A few ill-perceived comments

- There are hundreds different business models…
- Business models evolve so quickly, they cannot form any robust anchor for acccounting…
- Relying on a business model notion gives too much discretion to management…
- …is contrary to comparability…

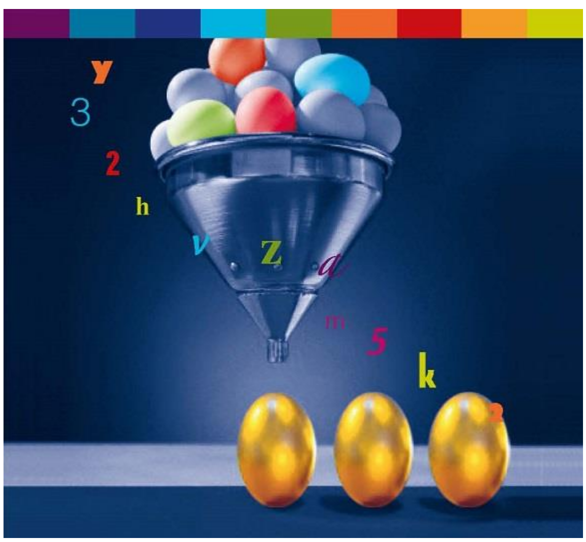
Business model: what do we mean?

- A specific description for financial reporting was needed

Business model = cash flow generation process

- How does the entity create value? What are the phenomena that trigger cash-flows?

How do you make money?



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Why is the notion needed?

- Cash flow generation *varies* depending on an entity's activities

Trader ≠ Manufacturer

- From a *relevance, reliability* and *comparability* perspective, financial positions and performance cannot be reflected as if their cash flow generation profiles were the same

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Business model / management intent

Business model	Management intent
Business models are both observable and verifiable based on assessing past and current actions	Management intent relates to future actions that cannot be observed
Once the business model is identified and observed, the accounting treatment related to a business model might not be at the choice of management	Management intent and the consequent accounting are at the choice of management

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What are we asking for?

- The business model notion should be described and articulated in the conceptual framework
- It may affect: recognition, measurement and presentation
- Satisfaction test for accounting requirements:

Are different cash flow generation profiles adequately depicted?

- ≠ systematic differentiation

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Have we been heard?

- Somewhat
- Business activities notion referred to in measurement
- No real guidance on how it should play a role

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Benefits expected

- Elimination of free choices, requirements based on the business model
- Consistency with management report, and more generally with financial reporting
- Reduction in non GAAP measures = adjusted GAAP

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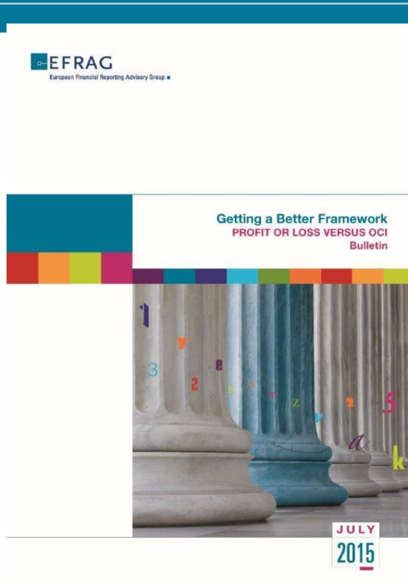
Performance – possible approach?



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Performance - possible approach?

- The revised Conceptual Framework states that:
  - Only income and expenses arising from remeasurements can be reported in OCI
- It presumes that:
  - All income and expenses go to P&L, unless excluding them makes P&L more relevant;
- But it does not explain when IASB should overcome the presumption

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Performance – possible approach?

- Extends and rationalises the ED proposals
- Aims at relevant performance reporting from a business model perspective
- Builds on debates held in the IASB Accounting Standards Advisory Forum (ASAF)

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A role for the distinction P/L and OCI

- 2 major ways of making money:
  - Transformation
  - Price changes
- 4 business models identified, however using some or a combination of the two elements above, combined with a time horizon
  - Long-term investment
  - Liability driven

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Performance – possible approach?

Step 1: Identify Business model

- Price change
- Transformation
- Long-term investment
- Liability driven

Step 2: Determine relevant measurement basis for primary performance (P/L)

Step 3: Test whether this measurement basis is relevant for the Statement of Financial Position; if not ≠ reported as OCI

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