acteo Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

afep

Mouvement des Entreprises de France MEDEF

EFRAG

35 Square de Meeûs

B-1000 Brussels

Belgium

Paris, 27 May 2014

Dear Madam Flores,

Re: The Role of the Business Model in Financial Statements – research Paper.

We welcome this opportunity to comment on this EFRAG research paper "The role of the business model in financial statements" (the Paper) since we firmly believe that the Business model has a key role to play in establishing financial statements and financial communication. We broadly agree with the main conclusions reached in this document, although we do propose an alternative approach to how the IASB should deal with the business model at the level of an individual standard.

Please do not hesitate to contact us if you require any further information or explanation.

Yours sincerely,

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	François SOULMAGNON Director General	Agnès LEPINAY Director of economic and financial affairs

1. The meaning of the notion of Business model

We support the general "assumed" meaning proposed in the Paper. This meaning is orientated towards a value-creation model and is similar to the definition we ourselves proposed to the IASB in response to its discussion paper on the Conceptual Framework, that is, "the strategy applied by the entity to manage its resources and obligations in order to create value".

The reference to the cash-flow conversion cycle seems useful to the extent that it permits to identification of features that can be used to differentiate between the different business models and can justify specific accounting treatments. In this way, we support what is stated in paragraph 3.40 of the Paper, i.e. "*a discussion of the key characteristics of business models should be driven by the objective of determining which characteristic could be of interest for accounting purposes".* We also agree with the main features of the cash flow conversion cycle that are listed: the length of the activity cycle, the use of inputs and outputs, the types of risks related to the activity, and the degree of certainty in the generation of cash flow. The Business model could also be characterized and differentiated by the way some entities combine assets or assets and liabilities in order to create value.

Moreover, we share the conclusion reached in the Paper that there is a significant difference between the business model and management intent. One major difference is the area of the scope and duration of the business model, which tends to be broader and more stable over time. Management intent, on the other hand, involves shorter-term management of more specific and targeted items or transactions. Management intent can be seen as the necessary flexibility in the application of the Business model. In this perspective, it also seems important to acknowledge and affirm that business models can and do change, even though these changes are by nature much less frequent than changes in management intent.

Regarding the three examples given in chapter 3 of the Paper (the banking, mobile-phone and insurance examples), we believe that in these examples the fundamental characteristics that can define a business model do differ significantly between the two models described and could justify different but appropriate accounting treatments. Moreover, we think the response would be the same if several "business models" were housed in the same entity, because we believe that one should not restrict an entity to a single business model. To do so would not provide a realistic depiction of how business is conducted today).

2. **How the business model helps achieve the objectives and qualitative characteristics identified for general purpose financial reporting**

We are entirely convinced not only that the business model helps but that it is actually an essential tool to achieve the objectives and qualitative characteristics assigned to financial reporting in the conceptual framework:

- ***Relevant information:*** we fully share the view of those who argue that ignoring the business model "would result in accounts that are established on a theoretical basis and produce information that is not based on economic reality" and thus not relevant. We also agree that users need a cohesive set of information, encompassing more than just the financial statements and that the only way to ensure this cohesiveness is that all this information relies on the business model.
  Reliable information should be specific and this is why we are strongly opposed to providing "uniform and hypothetical information" in the primary financial statements. The business model should be reflected from the outset in the accounting model and not relegated to the notes. Primary financial statements should reflect probable future cash flows measured using the valuation method that best reflects the most likely way an entity will realize the cash flows. Not to do so would result in biased information since the financial statements would reflect hypothetical future cash-flows with a low probability of occurrence.

- ***Faithful representation of economic phenomena:*** First, we would like to clarify that we do not fully support this recently added (in 2010) objective of the conceptual framework, since we think that the promotion of this notion to the detriment of those of prudence and reliability does not contribute to the quality or relevance of financial statements.
  Indeed, when the Board decided to replace the notion of "reliability" with that of "faithful representation", our main concern was the way that this "faithful representation" notion was defined. While we agreed with the "complete and free from error" characteristics, we were opposed to the "neutral" attribute given to faithful representation which in many cases may conflict with the "relevance" characteristic which has been set as the first qualitative characteristic in the framework. Indeed, this focus on neutrality has gradually led the Board to give more weight to external perspectives, whether these be relevant or not, than to internal management's assessment of its business model and how it should affect the representation of economic events. Furthermore, the impact of the notion of neutrality has been reinforced by the comparability criteria, which has been placed first in the list of enhancing qualitative characteristics. Even though the Board has specified that "comparability is not uniformity", we believe that, in practice, this consideration has been ignored in many cases.

  Notwithstanding our concerns about the objective of faithful representation as discussed above, we agree with those who affirm that "reflecting financial information on a basis that is not aligned with the entity's business model is failing to be faithful representative as it portrays the assets and liabilities, income and expenses, as if they were held and generated in an entity different from the reporting entity".

- ***Comparability:*** as stated above, we are among those who strongly believe that comparability is not uniformity. We therefore believe that the business model can help to achieve comparability since it highlights “like things that must look alike but also different things that must look different”.

- ***Stewardship:*** even if stewardship is no longer a stand-alone objective in the new framework, we believe that only reporting based on the business model allows the user to assess management’s performance in discharging its duties. We therefore agree with the Paper’s conclusion that users of financial statements need information to allow them properly to judge how management has fulfilled its responsibilities in using those resources, and that is useful to highlight differences in the financial performance resulting from to the application of different business models.

3. Implication of the business model in financial statements

- ***At the conceptual framework level:*** we believe that at this stage the IASB should remain at quite a high level but should establish the following principles :

    - The business model has a key role to play in establishing financial reporting as it is an essential tool in the achievement of the objectives and qualitative characteristics set out in the first chapter of the framework.

    - The role the business model might play should be assessed at each stage of financial reporting: identification of assets and liabilities, recognition measurement, presentation and disclosure.

    - The framework should provide a high-level description of what the notion of business model means. It should indicate that the business model is a notion orientated towards the creation of value and is to be characterized by the features proposed in the Paper, based on the cash-flow conversion cycle.

    - The framework should acknowledge that a single reporting entity may host more than one business model and that, in some rare circumstances, business models can, and indeed do, change.

    - Finally, the framework should establish how the IASB should apply this notion in each individual standard (see the following proposals)

- ***At individual standard level :***

  - The Board should not, and indeed cannot, define for each standard one or more business models that would be dealt with in the standard. It should restrict its approach to identifying the differentiating features that may justify different accounting treatments.

  - The Board should consider whether, in the particular case of the elements covered by the standard, different accounting principles would be relevant to distinguish between the different profiles of business models.

  - Having determined that it would be relevant to distinguish between business models, the Board should determine which characteristics are decisive in the choice of accounting model and which accounting model is the most appropriate for each profile. This determination should be based on the main characteristics common to the business models (see cash conversion cycle),

Illustrative example of our proposed alternative approach - IAS 16 fixed assets

The standard can establish the principle that different measurement approaches are relevant depending on the characteristics of the business models. The Board could then propose an analysis grid that may help entities to select the appropriate accounting treatment depending on the main characteristic of their business model.

Please note that the table below is purely hypothetical, prepared for illustrative purposes only and does not represent any view on the appropriate accounting model.

	Amortised cost	FVTPL	FVOCI
The length of the activity cycle	ND	ND	
How inputs are used	Asset used to transform inputs	No transformation of input	
How outputs are used to generate cash	Rents (for property)	Disposal (for property)	Mixed
The types of risks related to the activity	Obsolescence	Change in market price	
The degree of certainty in the generation of cash flows	High degree of certainty	Uncertain	

ND : non-determinant features for this specific aspect of the standard

Preparers will then identify which characteristics are specific to, and the most important for, their business model and deduce the most appropriate valuation method. For an industrial company, the main features of its business model would probably those corresponding to amortized cost (this may call into question the relevance of the optional “fair value model” proposed today in IAS 16).