

EFRAG
Francoise Flores
35 Square de Meeûs
B-1000 Brussels
Belgium

RE: The role of the business model in financial statements - RESEARCH PAPER

Dear Francoise,

The European Securities and Markets Authority (ESMA) thanks you for this opportunity to contribute to EFRAG's proactive activities. ESMA has considered the Invitation to Comment on the *EFRAG, French Autorité des Normes Comptables (ANC) and UK Financial Reporting Council (FRC) Research Paper: The role of the business model in financial statements (the Research Paper)*. We are pleased to provide you with the following comments with the aim of improving the transparency and decision usefulness of financial statements.

The Research Paper intends to show that the concept of business model is an implicit part of the International Financial Reporting Standards (IFRS), although it is not mentioned in the IFRS Conceptual Framework and it was clearly not identified in the IFRS literature before the development of the IFRS 9 – *Financial Instruments*. The research paper argues that it is time for a change and that as the business model plays a role in financial reporting it should be considered as part of the revised IFRS Conceptual Framework.

ESMA agrees that the examples provided in the Research Paper highlight that the use of business model at a standard level could result in more relevant information on the financial performance, financial position and cash flows of an entity and assist investors in their risk assessment and economic decisions. ESMA also agrees that the cash conversion cycle could be helpful to identify the business model as it could be indicative of the extent to which an entity's activities are exposed to risks through analysis of the expected cash flows.



However, ESMA acknowledges the risk that the use of different accounting treatments for different business models could harm comparability amongst issuers. Thus we believe there should be a duly justified trade-off between relevance and comparability of the information when deciding on such an approach. Therefore, ESMA believes that the use of different accounting treatments for different business models should be decided at standard level, based on clear and objective principles, such as in IFRS 9.

In view of the above, ESMA does not oppose that the IASB assesses whether fundamental differences in business models justify differences in accounting models when developing new standards. We are convinced about the benefits of an extensive inclusion of the business model concept in the Conceptual Framework, but a general provision that the 'business model' should be assessed when setting individual standards could be sufficient.

In supporting this view, ESMA observes that, as evidenced in the Research Paper, it is still very difficult to have a general definition of the 'business model' at the IFRS Conceptual Framework level¹ because of the lack of common understanding of this concept. While many attributes could be included or used to identify a 'business model', a proper distinction between 'business model' and 'management intent' is lacking. As a consequence, we are concerned that introducing a too broad definition of 'business model' in the IFRS Conceptual Framework might lead to too many different accounting models not justified by fundamental differences between business models.

Furthermore, ESMA is unsure how the 'business model' concept should play a role in the recognition at the level of IFRS Conceptual Framework as recognition is largely driven by the notions of control and risks and rewards. Regarding the proposal in the Research Paper to use the 'business model' concept as criteria triggering recognition in Other Comprehensive Income (OCI), ESMA believes that it should not be allowed in the absence of a proper definition for the OCI.

We would be happy to discuss all or any of these issues further with you.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'S/M' with a flourish.

Steven Maijoor
Chair
European Securities and Markets Authority

¹¹ ESMA/2013/1951 - ESMA Comment Letter on the IASB's Discussion paper - A review of the Conceptual Framework for Financial Reporting.