EFRAG

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EFRAG, The role of the business model in financial statements, RESEARCH PAPER

Representing preparers' point of view, the Swedish Enterprise Accounting Group (SEAG) welcomes the opportunity to comment on the Research Paper (RP).

It is clear that IFRS already takes business models into account in some specific standards. We do not support that business models should be given greater prominence in general when setting standards. We believe that IFRSs should be based on general principles that can applied by companies with different types of business models. We are concerned that a frequent use of business model thinking in financial reporting standard-setting might lead to a development of special rules for specific business models, which could be detrimental to the idea of principle based standards.

We have further developed our view by answering some of the questions raised in the DP in the Appendix to this letter.

We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

CONFEDERATION OF SWEDISH ENTERPRISE

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The Swedish Enterprise Accounting Group (SEAG) represents more than 40 international industrial and commercial groups, most of them listed. The largest SEAG companies are active through sales or production in more than 100 countries.

Appendix

Question 1 - Implicit use of the business model

Chapter 2 discusses the explicit use of the term ‘business model’ in IFRS. The chapter also includes implicit examples of earlier use of the business model.

(a) Do you support the analysis of the implicit examples in IFRS? Please explain.
(b) Are you aware of additional implicit examples in IFRS?

We have a general comment. Based on our experience from mainly industrial companies the definition of business models within a company is mostly rather straightforward. But sometimes even changes within in an existing business model might require changes of accounting. The business models are to a great extent externally presented in the non-financial part of an annual report. This means that users often can find information about business models in a specific company.

Question 2 - Cash conversion cycle

Chapter 3 discusses the assumed meaning of the business model, including an analysis of the cash conversion cycle.

(a) Do you agree with the analysis of the cash conversion cycle? Please explain.
(b) Are there any other attributes to add?

N/A

Chapter 3 also includes examples of business models and raises recognition and measurement issues for each example with alternative views.

Question 3.1 - Banking example

(a) Do you think the example describes different business models? Please explain.
(b) Do you support View A or View B? Please explain.
(c) If the different activities of Entity A and Entity B were both conducted in the same entity, would your answer to the above question be different? If so, why?

N/A

Question 3.2 - Mobile network operator example

a) Do you think the example describes different business models? Please explain.

Yes, in theory. But in reality most operators have a mix of own distribution channels (own stores, Internet etc.) and retail dealers. In many cases the agreement with the mobile phone device manufacturer is between the telecom operator and the manufacturer directly. Many telecom operators then also use a third party as a distribution company who manages the stock of devices.

When it comes to the cash flows from the customer to the telecom operator it usually includes the instalment payment for the device somehow, either as a separate part of the contract or bundled with the subscription of services. Thus company B usually has the same risk for not covering the cost of the device as company A.

b) Do you support View A or View B? Please explain.

In general we support view B based on what is described above under (a). If the telecom operator acts more as an agent for the dealer then it would be a different business model which would demand a different accounting method.

c) If the different sales channels of Entity A and Entity B were both conducted in the same entity, would your answer to the above question be different? If so, why?

No, not if they are economically similar (as described under (a) above). If similar, then they should be accounted for the same way. But if the telecom operator acts as an agent for the dealer then the transaction would be accounted for in a different way.

We have two other additional comments to the example:

- *We recommend that a comment is made that more than one performance obligation should be considered in the example, even if it not specifically required in relation to the issue discussed.*
- *Subsidy. In our view, a subsidy is a rebate and as such should impact revenue and not cost. This (might) require(s) another B/S treatment as well.*

Question 3.3 - Insurance example

(a) Do you think the example describes different business models? Please explain. (b) Do you support View A or View B? Please explain. (c) If both insurance products of Entity A and Entity B were provided by the same entity, would your answer to the above question be different? If so, why?

N/A

Question 4 - Playing a role in financial reporting

Chapter 4 discusses the conceptual debate as to whether the business model should play a role in financial statements. The Bulletin includes a tentative view that the business model should play a role in financial reporting, including financial statements, and asked whether constituents support that view.

Do you have any additional comments?

EFRAG recommends that business model impact shall be considered to a larger extent in the conceptual framework and when the IASB prepares new standards.

If you regard the IFRS standards as a toolbox you could argue that business model already is reflected to some degree. That is, each company selects the tools most appropriate for their business model among the standards available. If business model would play a bigger part in financial reporting then how would it be done? Would there be a toolbox per business model? Meaning certain accounting principles, tools, would be allowed and others would not be depending on the business model chosen. Or could the business model give companies the mandate to make tools of their own along the lines of IAS 1 paragraph 19? "In the extremely rare circumstances in which management concludes that compliance with a *requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements…"*

We note that using business model in financial reporting would fit well together with the ideas in integrated reporting, where business model is a key concept. But it is difficult to assess the use of business model because of the vague definition. We also note that it would perhaps not fit so well with XBRL reporting, which has a more static approach to disclosures.

To consider business models would also mean a shift from the previous trend towards fair value based accounting. That we agree with.

Our view is, however, that as a basic principle IFRS should provide the tools (the principle based standards) that shall be applied by companies when preparing financial statements. Based on our experience, this approach generally works well under IFRS today. Take for example the new standard for revenue recognition (IFRS 15). The standard logically covers a great number of business models in different types of companies and new business models will evolve over time. We do not understand why a reference to business model (in the Conceptual Framework) should be needed or improve information value to financial reporting. It is essential that IFRS is "up to speed" with new types of business and technology. We think that accounting should simply reflect the underlying business performance and not create business models for financial reporting purposes.

That IFRS 8 allows a business model approach on segment level is logical due to that this reflects the internal accounting principles of a company. Despite this possibility, there might be a few companies with business models that are not well reflected by IFRS at some point of time. Instead of applying business model thinking in general we recommend that the IASB considers an amendment of paragraph 19 of IAS 1 to allow for adoption of "own tools" in some situations. Our understanding is that paragraph 19 of IAS 1 today is interpreted in such a way that no deviations are acceptable in practice. We believe that this is contrary to the purpose behind the standard. A restricted possibility to deviate would according to our view solve some of the issues associated with applying a business model in financial reporting.

Question 5 - Criteria for use of the business model

Chapter 5 discusses the implications of the business model in IFRS and proposes criteria to be used in the Conceptual Framework to identify when the business model might be used in accounting standards. The chapter also proposes principles for identifying business models in those accounting standards.

(a) Do you agree that criteria should be included in the Framework to provide a more systematic approach for accounting standard setters to consider the business model?

Yes, if business model mean getting more tools in the IFRS toolbox without compromising a principle based approach and this in turn improves financial reporting for the benefit of users, then it would be a good thing.

(b) If so, do you agree with the suggested criteria?

In developing new standards these criteria may be useful to keep in mind and test against. At the same time preparers would have to describe their business model(s) and reasons as to why they have chosen these specific “tools” for their reporting.

(c) Are there additional criteria that should be included? Please explain.

N/A

Question 6 - Implications of the business model

The Bulletin proposes some implications to IFRS and asks whether constituents support the implications to the IFRS literature.

Do you have any additional comments?

See our comments under question 4.