IASB
30 Cannon Street
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Paris, March 27, 2013

Re: ED 2012/3 Equity Method: Share of Other Net Asset Changes
ED 2012/6 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

We welcome the opportunity to respond to the Invitation to Comment on the above exposure drafts.

In view of the two draft amendments under review, it seems clear to us that the equity method raises a lot of both practical and conceptual issues that deserve to be treated in a comprehensive project rather than being dealt with in a series of amendments in such a piecemeal fashion. It is all the more important to treat these issues thoroughly and appropriately now that IFRS 11 may significantly expand the scope of the equity method.

Current standards provide relatively little explicit guidance about the equity method, thus creating difficulties and/or divergences in implementation or interpretation that have now led the IFRIC to propose these amendments. It would be more efficient to have a comprehensive analysis concerning accounting for associates and joint ventures, rather than to make a series of targeted amendments, whose sole purpose is to solve short-term differences in observed practice.

Nonetheless, we understand that a comprehensive project will not be undertaken, much less completed within a short timeframe, and that the IASB has therefore attempted to propose pragmatic solutions to observed divergences in implementation. However, we think that in developing those pragmatic solutions, the Board must not create more issues / inconsistencies than it tries to solve, nor must it depart from existing principles.

We remain at your disposal should you need further clarification or background information.

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

Why is the equity method an issue?

The IASB often refers to IFRS 10 /IFRS 3 and proposes analogies to these standards to address situations of significant influence or joint control agreements, even though these standards are based on the principle of exclusive control, which is completely different from shared control or significant influence; One may therefore wonder how the principles developed in such standards as IFRS 3 and IFRS 10, which were written solely in an environment of exclusive control, might be applied to other forms of investment.

To add complexity, sometimes IAS 28 – Investments in Associates and JV- refers to the general principles developed in IFRS 3 and IFRS 10, while at other times specifies some contradictory provisions.

In this context, in the absence of clear principles regarding accounting for the equity method, companies have difficulties in identifying the appropriate accounting methods that should be applied as soon as the situations or transactions that occur are outside the specific provisions of the standards.

The following statements are not intended to rule on the appropriate treatment but only to highlight some of the inconsistencies we see:

- On acquisition of an investment (associate or JV), the entity should determine a goodwill (or badwill) which represents any excess (deficit) of the cost of its investment over its entity's share of the net fair value of the investee's identifiable assets and liabilities; the principles to be used to determine the fair value of the investee's identifiable net assets are those developed in IFRS 3.

  It may be noted that while referring to IFRS 3 for the determination of goodwill, the analogy is not complete because the equity method is in fine recorded at cost including acquisition costs, whereas under IFRS 3, acquisition-related costs are generally expensed as incurred. This "duality" in approach poses problems of interpretation in some cases which are not specifically addressed. For example, the issue of how to account for contingent price:

  - Should an obligation to pay contingent consideration under the equity method be accounted for when joint control or significant influence is obtained, as is the case under IFRS3, which specifies that the fair value of the liability should be estimated at the date on which the control is obtained and then subsequent adjustments recognised through net income?
  - Or should the liability be recognised at a later stage, as it seems to be the case for acquisitions of fixed and intangible assets (see current discussions within the Interpretation Committee)?
  - And should the remeasurement be accounted for as part of the investment carrying value, as IAS 28 requires the investment to be accounted for at cost?

- Regarding changes in ownership interest, again the current texts are not explicit, nor consistent :
  - IAS 28 specifies that when the ownership interest is reduced but the entity continues to apply the equity method, then the entity shall reclassify to profit or loss, the proportion of the gain or loss that had previously been recognised in OCI. This requirement is not consistent with the treatment adopted in IFRS 10, which requires that for a controlled entity such recycling occurs only when control is lost.
  - Meanwhile, no specific provisions are given in IAS 28 concerning the accounting for an increase in ownership interest when the entity continues to apply the equity method, nor concerning a step acquisition in a joint venture or associate. In a context where the principles for the equity method are not clearly defined, one may wonder whether one should apply by analogy the relevant provisions of IFRS 10 and IFRS 3, or choose an alternative accounting method because decreases in ownership interest are not accounted for identically for associates / joint ventures and for controlled entities.

ED /2012/6 Sale or Contribution of Associate between an Investor and its Associate or Joint-venture

We can understand the need to address a perceived inconsistency but believe that the proposed amendment is not conceptually robust:

Firstly, the underlying principle in IFRS 10 is that the loss of exclusive control over a subsidiary represents a significant economic event that justifies recognising a full gain or loss on disposal. In IFRS 10, however, this treatment is required for the loss of control of any subsidiaries: it does not specify that it applies only to a subsidiary that constitutes a business (as defined within IFRS 3). We are therefore not sure that an inconsistency exists which needs to be fixed: the IFRS 10 requirements should apply only if an entity contributes a subsidiary, whether or not this subsidiary holds a business. In addition, IFRS 10 does not prescribe any accounting treatment regarding the loss of control over solely a business while control over the subsidiary is maintained.

Secondly, if the principle is that a loss of control leads to the full recognition of the disposal gain or loss, this principle should then apply whatever the nature of the asset sold: whether it be a subsidiary, an individual asset or a business. We understand that the IFRIC raised questions about this issue but did not want to go further, fearing inevitable cross-cutting issues. We believe that it is not advisable to deal with only one aspect of the problem as this would create the risk of even greater inconsistencies between different standards.

Moreover, when an entity loses control over a subsidiary that then becomes a joint venture or an associate, the entity should recognise the fair value of the investment retained. This will impact the gain and losses recognised on disposal. If the IASB would like to apply a full analogy to all transfers/ sales of a business (or assets) to an associate (or joint venture), it should therefore require that the carrying amount of the investment be revalued. Such revaluation is automatic in the case of a contribution in exchange for an equity interest, but is nil in case of a monetary sale (net equity of the JV or associate remains identical before and after the transaction). It would therefore be useful to analyse first whether all transactions (contributions in return for an equity interest or sales) should be accounted for in the same way.

Finally, the different treatments that will result from this proposal, whereby the accounting will differ significantly depending on whether the transaction involves a business or a separate asset, will, in our view, probably lead to greater use of the concept of a business as defined in IFRS 3, and this will place increased pressure on a definition which is not always easy to put into practice.

For the above reasons, we do not support the proposed amendment. We believe it is not robust and may lead to more inconsistencies than it will solve. We note, for example, that in developing this amendment the Board has not considered how transfers (or sales) to a joint operation should be accounted for.

Finally, it seems clear from paragraph BC 8 that the Board intends that in the case of an "upstream" transfer of a business from an associate or joint venture to the investor, the investor should recognize its share of the associate's or joint venture's gains or losses on that disposal. However, the drafting of paragraph 31A does not make this clear. It might be clearer if it were specified that this paragraph relates to both upstream and downstream transactions.

ED 2012/3 Equity Method: Share of Other Net Asset Changes

As said in our cover letter, we understand the need for finding a pragmatic solution before the Board can undertake a comprehensive analysis of all issues related to the equity method.

We also agree with the Board that including some of the investor's share of the investee's equity transactions in profit or loss gives a misleading representation of the investee's performance, because such equity transactions do not reflect its performance (BC4). We think that therefore the first issue is to establish a principle about what represents the investee's performance for a current period so that one might identify which amounts should be recognised in the investor's share of net income. [In this respect, please find attached an example of a transaction for which we believe that accounting through net income does not make sense.]

All other changes that do not depict the investee's current period performance should be recognised in its OCI. We do not believe that recognising those changes in equity is a valid solution for all the following reasons:

- The proposed use of equity is inconsistent with the general principle of IAS 1 which states that equity should be used only for transactions between owners in their capacity as owners.
- With this proposal the IASB has also introduced a new source and use of recycling even though this notion is still under discussion within the ongoing project on the conceptual framework and current use of recycling is not consistent across IFRSs.
- In paragraph BC 10, the IASB observes that, without recycling some accumulated amounts recognised through equity will remain in shareholder's equity, even after the investor loses its significant influence. Because the IASB does not regard this as a "fair representation", it has proposed this new category of recycling, i.e. from equity to net income. We are quite surprised by this observation because under current IFRS 10, when an entity loses control of a subsidiary, some components of equity will remain forever within the group's equity. These components are those resulting from past increases or decreases in ownership interest without loss of control.

Still on the matter of the recycling mechanism, we wonder why the IASB proposes to require different treatments depending on whether the amount to be recycled came from equity (recycling only when the entity discontinues the equity method) or from OCI (recycling as soon as a decrease in ownership interest occurs even though equity accounting is continued (IAS 28paragraph 25).

As regards transition, retrospective application may impose costs that would exceed the benefits. We would therefore support a prospective approach.

Appendix: an example of a transaction for which we believe that accounting through net income does not make sense

An investor (A) acquires 30% of the capital of a listed investee composed of 1 000 shares (market price = 50 CU per share).

Acquisition cost = 30% * 1000 * 50 = 15 000 CU

In the same year, the investee plans to acquire an entity for 1 200 CU. This acquisition is financed by a capital increase to which A does not subscribe (either because he does not want to, or because he is not entitled to).

At the time of the capital increase, the share market price is 40 CU, creating a dilutive effect of (87*) CU in the value of A's investment in the investee. Although we believe that this dilution should be reported in the financial statements, we do not believe that it should impact the Investor's net income as it does not represents the performance of the Investor's investment during the period for the following principal reasons:

- The equity method is not a fair-value based measurement: spot price should not affect the Investor's performance; Spot price can only be an indicator that an impairment test should be performed => as long as the value in use is superior to the carrying amount, no loss should be recognised.
- The dilutive effect may be temporary and would not be realised until the investor sells all or part of its participation in the investee; as long as the value in use of the investment is superior to its original acquisition cost, the dilutive effect represents potentially only a lower post-acquisition interest (or lower potential profit) rather than a loss.

** In view of the market price of 40, 30 new shares had to be issued to obtain the 1200 CU needed for the forthcoming investment.*

After the increase in capital, A's percentage interest in the investee is now 29.1%.

The net asset of the Investee are now 51 200 CU and therefore the new share of the share of A is 14 913 CU.