EFRAG

35 Square de Meeûs

B-1000 Brussels

Belgium

Paris, 27 May 2014

Dear Madam Flores,

Re: EFRAG Paper: The Equity Method: A measurement basis or one-line consolidation?

We welcome the EFRAG initiative on equity accounting and are pleased to respond to the EFRAG Discussion Paper: The Equity Method: A measurement basis or one-line consolidation? (the Paper). It has become clear to us that the notion of equity accounting has recently given rise to a number of questions which have remained unanswered.

We note as evidence of this situation the issues which have been submitted to the IFRS Interpretations Committee (IFRIC) and for which IFRIC has proposed "temporary" solutions aimed only at enhancing comparability in the short term without providing robust and durable solutions on the conceptual front. In this respect, we think that each additional proposal for limited amendments contributes to the uncertainty around the equity method by highlighting the increasing instances of inconsistency.

We think that these issues stem essentially both from the problem of the definition of the "group" which makes up the reporting entity and from the lack of a clear objective for the incorporation of the performance of associates and joint ventures in the consolidated financial statements. These problems have, of course, been exacerbated by the application of IFRS 11 which has resulted in a significant increase in the number of entities incorporated by the equity method.

We do not think that it is possible to deal with the issue of the equity method by adopting an approach as "binary" as that proposed in the Paper. To reduce the issue to a simple choice between a consolidation method and a measurement method, with the consequential "automatic" and strict application of the relevant standards, will not, in our view, result in a helpful resolution of the issue.

We think that the first step is to reconsider the definition of the "group" [1] represented by the reporting entity. This debate, which was started in the 2008 discussion paper on the reporting entity, has not been brought to a conclusion. In our view it is essential to conclude on this. In the discussion paper the IASB had expressed its preference for the definition of a group based on the notion of (exclusive) control and had dismissed other possibilities such as that of a group based on the notion of risks and rewards. We wonder about the appropriateness of an approach based on control which thus excludes associates and joint ventures, relegating them to the status of simple financial investments with the implications that might have, such as for example, for the non-elimination of inter-company transactions. In fact, because of their very purpose and nature, it seems to us that these investments in associates and joint ventures cannot be regarded as simple financial assets. This difference in economic purpose and nature must be made manifest in the financial statements. The question is therefore that of the most relevant way of incorporating and presenting the performance of these investments in the accounts of the investor.

Consequently, we think that it is appropriate to define in a broader manner than at present the group within which value is created. The group would include, but account for using different methods, both subsidiaries (under exclusive control) and entities over which the investor enjoys joint control or significant influence and which are an integral part of its activities. These degrees of control or influence expose the investor to risks and rewards which it can act upon, and the management of the investor can be judged upon the performance of these entities.

These different components of the group would have different accounting methods for their integration in the group: IFRS 10 for subsidiaries and IFRS 11 and IAS 28 for the others. The accounting and presentation methods might be different, but all would be based on the common objective of including the results of the whole in a consistent way. We think that this should include the recognition of the net assets and the profit or loss to which the group has a right, the elimination of internal profits and the way the acquisition is accounted for.

<u>Accounting method for the integration of associates and joint ventures</u>

Since the IASB has decided to eliminate the option of proportionate consolidation, we think the equity method is the best suited to these entities. This method is well established and easily understandable. It provides a simple method of incorporating the group's share of the performance of the associate or joint venture in the period.

As far as the other possible methods are concerned:

- We think that accounting only for the dividends received in the period is insufficient to reflect the performance of the entity in a way comparable to the rest of the group for the period.
- A fair-value approach integrating outsiders' views of future performance and the inherent volatility of the financial markets does not seem any more relevant to us: this approach cannot translate the operational performance of the period into the group's results.

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[1] Please note that our comments about the definition of the group and the reporting entity are restricted to the use of these notions in IFRS reporting only. We have not considered the use of these terms or definitions in any other context where they may be used by reference to the "Group" as defined in IFRS.

We therefore conclude that the results provided today through the use of the equity method is appropriate for the incorporation in the group's results of the effect of the group's significant influence/joint control on the decisions taken by the associate or joint venture and its resulting performance.

How to resolve the issues with the equity method?

We think that many of the drawbacks and issues perceived with the equity method today could be resolved if the IASB were to treat the problem holistically and develop a dedicated standard for equity accounting. There is currently a lack of clear objectives for the equity method and a significant number of partial or incomplete references to other standards. Amendments proposed by the IFRIC deal with very limited issues and may have unintended consequences on other areas of equity accounting. As a result, faced with an absence of complete guidance one cannot be sure of the treatment to be applied in specific cases. The development of a comprehensive standard on the specific topic should resolve this. Such a project would also provide the opportunity to revise the scope of the use of the equity method, and specifically the definition of "significant influence" to ensure that the equity method cannot be applied in cases where investments are in substance of the nature of financial investments.

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

Yours sincerely,

ACTEO

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