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IASB
30 Cannon Street
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Paris, March 22nd 2013

Re: Alstom Comment letter on the IASB Exposure Draft "ED/2012/3"

Dear Madam/Sir,

We would like to thank you for the opportunity to provide comments on the Exposure Draft (ED) dealing with "Equity Method: Share of other net asset changes". Alstom welcomes the Board's initiative to address the diversity in practice on how issuers recognise their "Share of the changes in the net assets of an investee that are not recognised in profit or loss (P/L) or other comprehensive income (OCI) of the investee".

The Alstom Group is a world leader in the power generation and transmission markets and the rail transport market. The Group designs, supplies and services a complete range of technologically-advanced products and systems for its customers, and possesses a unique expertise in systems integration and through-life maintenance and services.

Alstom is very concerned by this Exposure Draft:

- **As an investee:** Since 2006 our main shareholder has used the equity method to account for its investment in Alstom.
- **As an investor:** Alstom has various jointly controlled entities that will be accounted for according to the equity method when the new standard IFRS 11 will be mandatorily applicable (2014 in Europe).

We agree with the IASB's proposal and support the underlying rationale to come up with the contemplated treatment to account for such changes in the investor's total equity. **We also welcome the proposal as a practical and simple expedient.** We think that recognising other net asset changes in the profit or loss of investors is not relevant and we encourage the Board to pursue its works on what constitutes **performance** reporting and the role of **OCI.**

We particularly agree with the paragraphs BC4 and BC6 of the ED. Other net asset changes cover various transactions, from different nature, which are accounted for as equity transactions in the investee's accounts and thus do not represent performance. By applying IAS 28, the investor should reflect in its profit or loss, its share of profit or loss of the investee. Therefore as those changes are not part of the investee's performance, they should not lead to profit or loss recognition in the investor's accounts.

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Alstom believes that the Board, after having clarified the notion of **performance and OCI** should re address that issue. An alternative view would be to include other net asset changes in the investor's OCI with an equivalent recycling trigger event rather than the investor's equity so as to avoid some inconsistencies with IAS 1 and the economic entity concept.

In addition to these main comments, answers to the questions listed in the invitation for comments are provided in the appendix.

Should you require any further comment or explanation, please do not hesitate to contact us.

Yours faithfully

Philippe Garin
Head of Accounting and Management Control

<u>Question 1</u>: the IASB proposes to amend IAS 28 so that an investor should recognise in the investor's equity its share of the changes in the net assets of the investee that are not recognised in profit or loss or OCI of the investee, and that are not distributions received. Do you agree? Why or why not?

<u>Preliminary remarks:</u>

- We agree with the IASB's proposal to return to the previous IFRS requirements and to account for the share of the other net asset changes through equity as an interim solution. This short-term solution should address diversity.
- These amendments shouldn't prevent the IASB from going on with the work they currently perform regarding what constitutes performance reporting and the role of OCI in particular.

1. **<u>Recognition of the other net asset changes in the investor's profit or loss is not consistent with the definition of the equity method</u>**

Under IAS 28.2, the equity method is an accounting method of an investment whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

This principle suggests that:

- the investment is re-measured based on the change in net assets of the investee,
- a symmetry should exist between the change in the components of net assets of the investee and those of the net assets of the investor that relate to the investment in the associate or joint venture.

The equity method is an accounting method of investment and not a consolidation of the underlying transaction of the investee. IAS 28 has still some similar procedures with the consolidation of subsidiaries such as accounting for the acquisition (IAS 28.26), adjustments necessary to give effect to uniform accounting policies (IAS 28.27), and treatment of gains and losses resulting from transactions between an entity and its associate (IAS 28.28). But it does not require re-analysing the accounting treatment of the operation of the investee and notably the transactions that have been accounted for in the investee's equity. Besides, IAS 28.21 states that when an associate has subsidiaries, associates or joint ventures, the profit or loss and net assets taken into account in applying the equity method are those recognized "in the associate's financial statements...", thus without adjusting component of the investee's net assets.

An approach that would consist in re-analysing the accounting treatment of the operation that has an effect on the equity of the investee would be costly and difficult to implement provided that there are numerous types of transactions (see 2. Below) and the investor does not have necessarily all the information on investee's operations.

2. Recognition of the other net asset changes in the investor's profit or loss is not relevant

"Other net asset changes" cover several types of transactions:

- Dilution/anti-dilution effects for the investor because of movements on the investee shares
- Transactions with non-controlling interests at the investee level
- Stock based plans granted by the investee (IFRS 2)
- Issuance by the investee of compound financial instruments comprising an equity component (convertible bonds...)

For us, it seems obvious that certain transactions should not be recognised in profit or loss because this should lead to counter-intuitive effects. For instance:

- the issuance of dilutive instruments by the investee; or
- the acquisition by the investee of its own shares: this should not be considered as a deemed acquisition, the anti-dilution effect should not be recognised as a profit.

That's why, we strongly agree with paragraph BC4 of the exposure draft: those transactions are equity transactions in the investee's accounts which do not involve recognition of income and expenses and, therefore, do not represent a performance of the investee.

Recognising other net asset changes in profit or loss would lead **to disclose a misleading representation** of the investee's performance and/or the investor's one. It will be contrary to IAS 28 which requires that the investor should reflect in its profit or loss, its share in the profit or loss of the investee (BC6). **By definition, operations that do not impact the investee's P/L, mechanically, by applying IAS 28, could not be recognised in the investor's one.**

3. Economic analysis of dilutions

As explained in our cover letter, this issue is a main topic for our Group. We strongly disagree with the alternative view of Mr Ochi. We think that **dilution transactions are in substance different from disposals**, and thus should not be recognised in P/L:

- Actual disposals are direct transactions between the investor and other shareholders of the investee that translate a partial return on capital investment.
- Dilution transactions result from investee's decisions and are not led by the investor's decision. The corresponding investee's changes in net assets do not reflect the return on the investment.

Illustrative example:

Associates are accounted for at cost and tested on their "value in use" based on discounted cash flow projections established by investors.

An investor acquires 25% of the capital of a listed investee composed of 2 000 shares (market price = 10 CU).

Acquisition cost = 25% * 2000 * 10 = 5 000 CU
Value in use (using DCF) = 5 050 CU

In the same year, the investee plans to acquire an entity for 2 000 CU. This acquisition is financed by a capital increase.

Let's take two hypotheses depending on the market prices of the investee at the date of transaction:

	Capital increase				
	Market price	New shares issued	Total shares of investee	Investor's shares	% of interest (A)
1st hyp : **market price decreases**	5 CU	400	2 400	500	20,8%
2nd hyp : **market price increases**	20 CU	100	2 100	500	23,8%

Determination of the dilution impact:

After capital increase	Net asset of the investee (B)	Share of the investor in the net assets of the investee (C) = (A) * (B)	Dilution impact (D) = (C) - 5 000	Value in use
1st hyp : **market price decreases**	22 000 CU	4 583 CU	**-417 CU**	5 300 CU
2nd hyp : **market price increases**	22 000 CU	5 238 CU	**238 CU**	5 300 CU

As the acquisition should be value-creating, the value in use has been reviewed to reflect the expected DCF.

In both cases, the value in use is independent from the variations of the market price, particularly when the stock exchange reflects macro-economic events. Before and after that acquisition, the investor has still 2 000 shares which value in use is higher than its share in the net assets of the investee.

The dilution impact is not part of the investee's performance, it mainly results from the changes in market price. The equity method is not a fair value model where changes in value would necessarily lead to profit and loss in the investor's accounts.

Recording such "one shot" impact in investor's P/L may undermine the long term strategy of investees, especially when investees are listed.

4. Recognition of other net asset changes (Equity or OCI?)

The definition given in IAS 28.3 of the equity method requires the investor to account initially the **investment at cost** and subsequently adjust for the post-acquisition changes in the investor's share of the investee's net assets. So these impacts should be recognised.

Therefore, on a short-term basis, Alstom agrees with the accounting principle proposed in the ED (i.e. accounting the "share of the changes in the net assets of an investee that are not recognised in profit or loss or OCI in the investee" in equity) as it returns to the previous requirements of IAS 28.

Nevertheless, at the investor's level, those transactions are not transactions with the investor's owners. Consequently, recognising these changes directly in the investor's equity should be inconsistent with IAS 1 (§ IN6). An amendment to IAS 1 should be provided.

An alternative solution should be the recognition of such impacts **in OCI**.

Question 2: the IASB also proposes that an investor shall reclassify to profit or loss the cumulative amount of equity that the investor had previously recognised when the investor discontinues the use of the equity method. Do you agree? Why or why not?

Recycling should be consistent with standards generally applied to equity or OCI:

- If the other changes in net assets are accounted in equity, it is not appropriate to introduce any recycling ;

- If they are accounted in OCI, we support the IASB proposal to recycle such changes when equity method is discontinued. In favour of this treatment while significant influence is maintained, those changes are neither representative of the performance of the investee nor sale or acquisition transaction of the investor over the shares of the investee. Significant influence maintains the nature of the investment as such. Thus, in that case, we also think, contrary to the current ED.25, that it would be meaningful not to recycle other OCI related to the investee in the investor's accounts when the ownership interest is reduced (current wording and proposal of IAS28.25). Instead **we favour recycling all OCI related to the investee (resulting from OCI of the investee or from other changes as scoped in the ED) at the time when equity method is discontinued.**