AIR FRANCE KLM

Senior Executive Vice-President, Finance

DG.DB (AFKL) 2008.04

Roissy, on September 16th, 2008

Dear Chairman Tweedie,

As a European private equity issuer, we welcome the opportunity to comment on the IASB discussion paper presenting preliminary views on amendments to IAS 19 Employee Benefits.

We provide a detailed analysis in the appendix to this letter.

Should you wish any supplementary comment or explanation, please do not hesitate to contact us.

Yours faithfully.

Philippe CALAVIA

Sir David Tweedie
Chairman
International Accounting Standards Board
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APPENDIX: Answer to the Discussion Paper – Preliminary views on Amendments to IAS 19 *Employee Benefits*

Questions 3 and 4 raised in the invitation to comment condition the answers to all other questions that are relevant to our company. Therefore shall we only answer these two questions.

Question 3

(a) Which approach to the presentation of changes in defined benefit costs provides the most useful information to users of financial statements? Why?
(b) In assessing the usefulness of information to users, what importance do you attach to each of the following factors, and why:
(i) presentation of some components of defined benefit cost in other comprehensive income; and
(ii) disaggregation of information about fair value?
(c) What would be the difficulties in applying each of the presentation approaches?

Question 4

(a) How could the Board improve the approaches discussed in this paper to provide more useful information to users of financial statements?
(b) Please explain any alternative approach to presentation that provides more useful information to users of financial statements. In what way does your approach provide more useful information to users of financial statements?

We disagree with the approach defined in chapter 3 of the Discussion Paper. As suggested in question 4, we therefore propose an alternative approach which according to us reflects a better economic approach.
Please refer below for a further detailed analysis.

I- General comments on concepts

The current IAS 19 allows companies to use either the "Corridor" methodology, or the "SoRIE" methodology, as presented in paragraphs IAS19-92 and IAS19-93. The "Corridor" methodology has the accounting consequence to spread the effect of certain assumptions changes, when they are outside the corridor, over the expected active life of the employees.

The Discussion Paper has for objective to recognize all the funded status in the balance sheet avoiding the non-recognized items. By this way, the DBO (Defined Benefit Obligation) as per IAS19-53 would appear at its fair value for the portion representing acquired rights, while the dedicated assets would be valued in the balance sheet at their fair value.
In substance, the concept of fair value applied to long term elements is introduced.

1- Concepts

We understand and support the objective of the IASB to harmonize the different methodologies applied. However, in order to be able to conclude about the most relevant methodology to apply, we believe that the revision of IAS19 "Employee Benefits" should have been launched after the revision of IAS1 "Financial Statements". In our opinion, a clearer definition of the net income and of Other Comprehensive Income would enable easier discussions about revisions of other standards.
We also believe that the wide range of existing regulations, markets and legal forms in the definition of pension plans should be taken into consideration prior to applying the concept of fair value to long term employee benefits reporting.

2- Measurement of the DBO

Regarding DBO, the full recognition on the face of the balance sheet will involve that it will change each year according to different items such as mortality tables, staff turnover or the discount rate, which is very volatile. For example, in the case of Air France-KLM Group, a variation of 1 point on the average discount rate has an impact of € 1.9 billion on the DBO. What can the market conclude from such a variation, and what is the economic reality lying beyond it in the short term?
According to us, such variations should not be directly presented in any performance reporting statement, but rather recognized over the underlying duration of the remaining working lives of concerned employees.

3- Measurement of funding assets

Concerning the funding assets, fair value valuation will involve that all the variation will be immediately recognized, contrarily to the corridor method currently applicable. When a company choses to have a dynamic management of its pension funds (for example to be on line with the age of the participants), a more or less large part will be invested in stocks. Variation of stocks is rarely in line with the "expected return on asset" rate on a yearly basis but, in average on a long term period, the return on asset is close to the expected return on asset. If the assets must be recorded at their fair value, big impacts will be recorded in the balance sheet each year.
For example, Air France-KLM Group's pension funds amount to € 13.4 billion as of March 31, 2008. The difference between the actual and the expected return on assets amount to € (989) million for the year ended March 31, 2008 and to € 207 million for the year ended March 31, 2007.

Of course, the fair market valuation reflects the exact situation as of the closing date. But what meaning may the income or the equity have if they bear an extreme volatility, whose economic reality spreads over the long term. Furthermore, this information is already disclosed.

In the same way, we also believe that it is very likely that users of financial statements would encounter difficulties while trying to calculate an entity's ratios (such as weighted average cost of capital, or return on investment). These users would certainly have to deduct the long term impacts induced by the revision of IAS19.

The only solution to avoid such "up and down" movements will be to invest pension funds in a mix of bonds and stocks in order to secure the level of funds. It is probable that after a little experience, management will ask for such solutions. Such movements from stocks to bonds could involve a crisis on financial markets (for Air France-KLM Group, the stocks portion represents about € 5 billion).

In several countries such as the United States, the United Kingdom, the Netherlands, etc, the level of funding is mandatory. For companies, there is no other issue but to record defined benefits plans. If the fair value approach is adopted, all the impacts due to the fair value approach will be included in the equity (by the P&L or by the OCI). That means that companies will support in their accounts the consequences of exogenous items such as discount rate, variation of stock exchange, minimum funding requirement laws, level of the defined benefit plans, etc.
This is totally different from the derivatives accounting: a company choses to hedge operations at a certain level with certain financial instruments. The consequences of these choices are reflected in its account.

II- Comments on the three proposed approaches

Comments on approach 1 described in paragraph 3.11

In this approach, all the changes in defined benefit obligation and in the value of plan assets would be recorded in profit or loss.

We disagree with this approach.

We do not agree as it will not reflect the performance of the company because of inclusion of exogenous data: many short-term variations tend to offset each other in the long-term, and the resulting information would confuse more than it would give clear information.

To illustrate, please see below the impact on result of the approach 1:

In € millions	Year 2004-05	Year 2005-06	Year 2006-07	Year 2007-08
Income from current operations (published)	550	936	1 240	1 405
Impact of approach 1	(345)	995	123	185
Income from current operations (restated)	205	1 931	1 363	1 590
Net result (published)	1 637	921	887	767
Impact of approach 1	(242)	697	86	130
Net result (restated)	1 395	1 618	973	897

This chart demonstrates that the addition of impact of approach changes in a significant way the performance of the Group. The readability of our income statement and balance sheet would become very hard for third parties.

Comments on approach 2 described in paragraphs 3.12, 3.13 and 3.14

In this approach, the service cost would be recognised in profit and loss while all other changes in assumptions would be recognised through equity.

We disagree with this approach.

According to us, this approach is not relevant because it is the alliance of an additional complexity and of the non-reflect of the performance.
The explanation that the companies would have to give to explain the split between the amount recognized in the income statement and the amount recognized in OCI will be somehow complicated, while IFRS aim to become a global set of standards, which induces in our opinion to be understandable by all users, as explained in paragraph I-3.

To illustrate, please see below the impact on net result and OCI of the approach 2:

In € millions	**Year 2004-05**	**Year 2005-06**	**Year 2006-07**	**Year 2007-08**
Net result (published)	1 637	921	887	767
Impact of approach 2	(48)	(119)	(167)	(179)
Net result (restated)	1 589	802	720	588
Total equity (published)	6 020	7 853	8 412	10 614
Impact of approach 2	(190)	641	902	1 207
Total equity (restated)	5 830	8 494	9 314	11 821

In addition, in certain countries like France, there is no minimum funding requirement. The approach 2 would give companies the possibility to monitor their income because they can chose to dedicate a certain level of funds invested in marketable securities for pension.
For example, if two companies have the same pension cost but the first (company A) has a pension fund and the second (company B) has devoted marketable securities to pay future pensions, we will have two different levels of result:

[gain / (loss)]	**Company A**	**Company B**
Service cost	(1 000)	(1 000)
Interest cost	(800)	(800)
Actual return on asset	700	700
P&L impact (before tax effect)	**(1 000)**	**(300)**
OCI impact (before tax effect)	**(100)**	**(800)**

As we can see, the same impact is not reflected in the same way and so, to compare the performance of these two entities, accounts should be restated.

As for approach 1, the readability of our income statement would become very hard for third parties.

Comments on approach 3 described in paragraphs 3.15 and 3.16

The main idea of this last approach is to account pension asset and liability at their fair value.

We disagree with this approach.

According to us, the fair value approach for pension is not adapted because of the very long term character of these items (in average between 15 and 20 years). The fair value will not give better information to third parties because its measurement is absolutely non reliable and depending largely on the choice of company to have optimistic or pessimistic approach on the actuarial assumptions (discount rate, turnover, etc.).

Moreover, all the arguments given in the general comments can be taken into account concerning approach 3:

- Volatility of the discount rate
- Management of funding according to accounting rules instead of according to management rules
- Exogenous items that will drive the balance sheet (discount rate, mortality table, variation of stock exchange, minimum funding requirement laws, level of the defined benefit plans, etc.)

Finally, all the impact recorded in OCI will never be recycled in income statement and only a "normative cost" would impact the net result. According to us, it is not a good reflect of the economy.

Conclusion

According to us, the information that users are expecting must not be based on the market value of assets and liabilities that are only realisable over a long period of time, but should rather be based on the recognition of benefits over the duration of the employees' working periods.
The information of the fair market value of pensions liabilities and their dedicated assets is already disclosed in the financial statements.
For example, we believe the corporate valuation during mergers & acquisitions operations will not take into consideration the volatile market value of assets and liabilities which will be realised over a long period of time. In order to have the best economic interpretation, the practice is based on normative elements, rather than exogenous ones.
We consequently believe that the 10% Corridor could be deleted, but that the methodology of amortizing actuarial gains and losses is the best method to value and present economically long term commitments.