Dear Sir,

AXA, a worldwide leader in Insurance and Financial Protection business and committed to delivering clear, complete and reliable financial information, welcomes the opportunity to comment on the proposed amendments to IFRS3, IAS 27 and IAS 37.

We support the comments that the French Conseil National de la Comptabilité (CNC) and ACTEO / MEDEF have respectively sent to you and for which we have participated in the preparation. Our intention is not to focus in detail on those comments but to emphasize some aspects and concerns that are of major importance.

We are favourable to the objective expressed in the Exposure Drafts for achieving international convergence. Nevertheless, we do not believe that this convergence should be reached by the way of significant changes such those that the proposals would introduce and on which we disagree.

Furthermore, we do not think that the proposed changes would lead to increase comparability and transparency of financial statements. They would not increase consistency as in many
cases the results will be more subjective than the ones presently required and therefore not truly comparable.

There is insufficient explanation as to why financial statements would be more relevant and more reliable by requiring the acquirer to recognise the acquiree at fair value and consequently adopting a full goodwill approach.

More specifically, we disagree on the following aspects of the Exposure Drafts:

- **Measuring 100 per cent of the fair value of the acquiree** (Questions 1 & 3 of invitation to comment on IFRS3 ED):

  We disagree with the measurement of 100 per cent of the fair value of the acquiree:

  - We believe that acquisitions of assets and acquisitions of businesses should be accounted in the same way, i.e. at cost as is the case under the related standards in-force (including current IFRS 3).

  - The proposed amendment would be premature, as the fair value’s concept and measurement are far for being finalised and may be subject to further significant changes in the near future.

  - Above all, in the specific case of an acquired business the measurement of its fair value as defined in the project would be strongly subjective since it would be impossible to refer to quoted market prices in absence of a liquid market. It would also be difficult to derive it from the consideration transferred which would be the only available reference but is specific to the entity:

    - In assessing the acquisition cost, and as described in ED-A15, an acquirer takes into account criteria which are specific to them, in particular synergies which it may be alone to expect in comparison to other potential acquirers. Other factors can be primordial, such as the acquirer's position on the market, for instance the fact there is no other potential buyer, or the objective for the acquirer to enter a new business, to become the leader entity, or to eliminate a competitor. Then, the price offered reflects the value the combination can add to the acquiree.

    - Very often, potential acquirers use expert valuations that show significant differences in the valuations of businesses: the valuations assist the management in making their acquisition decisions, but they are far from being reliable enough for financial statements purposes and do not reflect actual transactions.

    - Several values for an acquiree can exist, in particular because acquisitions respond to objectives that are different from one potential buyer to another. As a result, the measurement of the fair value of the acquiree, as a whole (that is to estimate the price at which 100% of the acquiree could be exchanged in a current transaction between knowledgeable, unrelated willing parties when neither party is acting under compulsion), and taking into account that marketplace participants similar to the acquirer might be able to achieve, is very judgemental and less reliable than the current IFRS3 cost approach.
Moreover, restrictions in the proposal to the fair value measurement in cases of overpayments and underpayments show the difficulties for applying the 100% fair value measurement principle.

We are convinced that in a business combination in which the acquirer holds less than 100% of the equity interests of the acquiree at the acquisition date, the proposed accounting would not produce more relevant and more useful information. In fact it would be the opposite, as this information would be misleading, in particular due to the allocation of the goodwill between controlling-interests and non-controlling-interests and would suppress valuable information provided under the current parent-company approach.

• **Allocation of goodwill between controlling-interests and non-controlling interests**  
(Question 3 of invitation to comment on IFRS3 ED):

Not only the total fair value of the acquiree is difficult to determine but so is the allocation of the goodwill between the controlling interests and the non-controlling interests. The Exposure Draft does not provide robust guidance on the allocation of goodwill. In many cases, the allocation would result in information not picturing the reality of the transaction, as shown in the example below:

<table>
<thead>
<tr>
<th>Treatment in Exposure Draft of IFRS 3</th>
<th>Current treatment under IFRS3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>In N : A acquires 60% of B</strong></td>
<td></td>
</tr>
<tr>
<td>Fair value of the acquiree B (100%)</td>
<td>10000</td>
</tr>
<tr>
<td>Consideration paid by A for 60% of B</td>
<td>6500</td>
</tr>
<tr>
<td>Net recognised assets of B at fair value (100%)</td>
<td>8000</td>
</tr>
<tr>
<td>of which controlling interests share 60%</td>
<td>4800</td>
</tr>
<tr>
<td>of which non-controlling interests share 40%</td>
<td>3200</td>
</tr>
<tr>
<td>Total Goodwill (100%) :</td>
<td>2000</td>
</tr>
<tr>
<td>allocated to controlling interests for</td>
<td>1700</td>
</tr>
<tr>
<td>allocated to non-controlling interests for</td>
<td>300</td>
</tr>
<tr>
<td>Total value of controlling interests</td>
<td>6500</td>
</tr>
<tr>
<td>Total value of non-controlling interests</td>
<td>3500</td>
</tr>
<tr>
<td>Total value</td>
<td>10000</td>
</tr>
</tbody>
</table>

With the treatment proposed in Exposure Draft of IFRS3, non-controlling interests are understated because the amount recognised in the IFRS consolidated balance sheet (3500) does not reflect the share of non controlling interests in the global fair value of the acquiree which amounts to 10000 * 40% = 4000. This is because the share of non-controlling interests in the goodwill is the result of a residual calculation. Then, the full goodwill method is likely to be misleading.
In particular, the information provided would be misleading if the consideration paid:

- takes into account synergies expected for the controlling group which benefit to subsidiaries other than the acquiree and then not included in the total fair value of the acquiree,

- includes overpayments (as goodwill is recognised even in case of overpayments, then only after tests for impairment),

- includes a control premium not reflecting future benefits for the subsidiary itself (but rather for the whole group). On that topic, we note that IAS 27 ED-30B states that if an 80 per cent controlling interest in a subsidiary were acquired at an amount that exceeds 80 per cent of the subsidiary’s fair value because the acquirer paid a premium to obtain control of the acquiree, then 80 per cent of the net identifiable assets would be attributed to equity holders of the parent, but more than 80 per cent of goodwill would be attributed to them.

In most cases, the amount recognised for the non-controlling interests would not reflect their actual fair value at the date of the acquisition that, in practice, depends of each specific situation, for instance if there is only one isolated non-controlling interests shareholder or, in the contrary, if non controlling shareholders are dispersed).

In conclusion, as its measurement shows that goodwill is different from other assets, and for all the reasons presented above, we disagree with full goodwill approach. We believe that the current IFRS 3 “cost” basis for valuing the acquiree and the parent company approach for valuing goodwill are the more objective and reliable measurement method.

- **Definition of a business combination** (Question 1 of invitation to comment on IFRS3 ED):

In our view, the definition of a business combination in the Exposure Draft excludes true mergers and business combinations where there is no acquirer. This in particular is the case of a combination of mutual entities where no entity acquires the control of another entities.

- **Definition of a business** (Question 2 of invitation to comment on IFRS3 ED):

With the notion of “capable of being conducted or managed”, the distinction between a group of assets and a business is reduced to a very narrow line subject to interpretations (as most assets or groups of assets are capable of being conducted or managed as a business), all the more that the accounting treatment would differ. For instance it could be the case of a group of investment properties and would conflict with IAS 40.
• **Contingent consideration** (Question 6 of invitation to comment on IFRS3 ED):

We disagree with the change in accounting for contingent consideration after the acquisition date.

The recognition in profit and loss of subsequent changes in the fair value of contingent considerations could have a counterintuitive effect on subsequent financial reporting:

- If better than expected results increase the contingency payment, it would lead to a charge to income, in some cases not economically relevant.

- If worse than expected results decrease the contingency payment, it would result in a gain, in some cases also not economically relevant.

In addition, contingent considerations are often used where acquirer and seller cannot agree on the price or when there are uncertainties on the future business operations:

- Consequently, the fair value of contingent consideration is very complex to measure with reliability at the acquisition date.

- Furthermore, we believe that post-combination events triggering contingent consideration to be paid change the fair value of the consideration paid for the interest in the acquiree: they confirm or negate the estimate of the acquiree’s value at the date of acquisition.

For these reasons, the current accounting for contingent consideration after the acquisition date is, in our view, more appropriate.

We also note that the proposed definition of a contingent consideration is too narrow as it includes only additional obligations for the acquirer and not a possible reduction in the acquisition cost. In particular, securities given by the seller should be treated as contingent considerations. Then, in practice, price adjustments can be positive or negative.

• **Direct acquisition costs** (Question 7 of invitation to comment on IFRS3 ED):

The Exposure Draft is inconsistent with other IFRS where transaction costs incurred in the acquisition or issue of assets or liabilities are accounted for as part of the valuation of the asset or liability, except, for obvious reason, for financial instruments at fair value through profit or loss.

Furthermore, we consider that direct acquisition costs are an integral part of the investment decided by the acquirer.

We therefore recommend keeping the current principle unchanged.

• **Probability criterion for recognising assets and liabilities** (Question 8 of invitation to comment on IFRS3 ED; Question 5 of invitation to comment on IAS 37 ED):
The probability criterion for recognising assets and liabilities has been abandoned because the Board considers that «in all cases an unconditional right or obligation satisfies the criterion». It is proposed to use the probability criterion in the measurement of these rights and obligations.

We do not support this conceptual change and believe that probability should be kept as a recognition criterion. In practice, the proposal may lead to recognising assets and liabilities whose value is based on unreliable measurement. In addition, we think that the triggering event of an unconditional obligation (or right) is not clearly defined.

- **Previously acquired non-controlling equity investment on the date the control is obtained** (Question 10 of invitation to comment on IFRS3 ED):

  We do not agree that the change in the fair value of the acquirer’s non controlling equity investment in the acquiree be recognised through profit or loss at the date of acquisition as if it had been sold and immediately repurchased.

  Furthermore, we do not support the revaluation of previously acquired goodwill. We recommend that until these equity interests are sold, the difference between a) the share of these interests in the fair value of the acquiree’s identifiable assets and liabilities assumed at the date control is obtained and b) their cost (including any existing goodwill) in the consolidated financial statements just before control is obtained, should be accounted for as unrealised gains and losses arising on available for sale assets.

- **Increases and decreases of interests after control is obtained** (Question 1 of invitation to comment on IAS 27 ED):

  - **Increases of interests after control is obtained**

    For a group acquiring non-controlling interests of a subsidiary that has been largely developed since the control was obtained, the proposed treatment under IAS 27 ED would lead to a material decrease in its controlling interests share in equity at the date of the additional acquisition. The more prosperous the subsidiary has been over time, the greater decrease reported in equity while actually in counterpart, the controlling interests would have access to future economic benefits that were previously attributed to non-controlling interests.

    Indeed, as purchase transactions should be reflected directly in equity (rather than in goodwill and revaluation of assets):

    - Unrealised gains/losses (especially on financial assets classified as available-for-sale) recognised through equity that are allocated to the non-controlling interests will be assigned to the controlling-interests upon additional purchase (to the extent of the additional purchase).

    - As a consequence, these unrealized gains and losses will be “recycled”/ recognized later in the consolidated profit and loss (when assets are sold) for the controlling-interests share.
- If the group would subsequently dispose of the controlled subsidiary, amounts previously recognised in equity would be included in the consolidated gain or loss of sale. Then, if the controlling interests share in equity was negatively impacted by a previous purchase of minority non-controlling interests, as a counterpart, there would be a higher gain in case of sale of the subsidiary.

The proposed amendments are likely to affect the relevance of future consolidated financial statements as, in some cases, the accounting of transactions will not reflect their economic reality, in particular the increase (or decrease) of the value of the subsidiary that has occurred over time and which is taken into account in the price agreed with non-controlling interests.

The alternative ED AV 10 proposes to recognise an additional goodwill for the excess of the consideration paid to the non-controlling interests on the share of net assets acquired. However, we believe it is also misleading when the excess reflects unrealised gains recognised through equity:

- The total balance sheet is overvalued, as assets are already recorded at fair value.
- Like for the proposal in ED, unrealised gains recognised through equity that were previously allocated to non-controlling interest will be assigned to the Group.

Finally, we recommend that upon subsequent acquisition of non-controlling interests, the difference between the consideration paid to the non-controlling interests and the share of net assets acquired be allocated between:

- First unrealised gains/losses recognised through equity (that were previously attributed to the non-controlling interests), in order that they may not be recycled through the controlling interests share in net income in the future, and
- Then goodwill as a residual.

We are aware that it is an intermediate solution compared to the revaluation (in proportion of non-controlling interests acquired) of all assets and liabilities of the subsidiary that would require a pure approach. However, for reasons of practicability, we believe that it is the more appropriate method.

The example presented next page illustrates this other treatment proposed and gives a comparison with the accounting that would be required under the Exposure Draft of IAS 27.
Note: the following example continues the example presented above page 3 for the accounting when control is obtained.

Reminder:
Total Goodwill (100%):
allocated to controlling interests for
allocated to non-controlling interests for

In N+3, A acquires non-controlling interests of B (40%) for 6000

Assumptions:
In N+3, net recognised assets of B (100%) excluding unrealised gains recorded in equity
Unrealised gains recognised in equity on financial assets classified as available-for-sale

=> Additional share acquired (40%) in:
- net recognised assets
- existing goodwill

=> Revaluation at fair value (for the additional share acquired) of financial assets classified as available-for-sale

Change in equity (excluding unrealised gains recorded in equity) resulting from the acquisition of non-controlling interests

Unrealised gains recognised in equity (controlling interests share)
- before the acquisition of non-controlling interests
- impact of the non-controlling interests acquisition
- after the acquisition of non-controlling interests

Goodwill (controlling interests share)
- before the acquisition of non-controlling interests
- impact of the non-controlling interests acquisition
- after the acquisition of non-controlling interests

Our view is that the decrease in equity of -2100 (for the controlling-interests share), resulting from the treatment proposed by the ED on IAS 27, is economically misleading. As proposed in the other treatment, the acquisition of non-controlling interests should not impact the share of controlling interests in equity.

In N+6, B sells all the financial assets classified as available-for-sale

Our view is that the additional profit of 1500 - 900 = 600 resulting from the treatment proposed by the ED on IAS 27 is economically misleading.

In N+7, A sells 100% of B for 16000

Selling price

Our view is that the additional gain of 3000 - 1500 = 1500 resulting from the treatment proposed by the ED on IAS 27 is economically misleading.
- Decreases of interests after control is obtained

We do not see benefits that the proposed treatment through equity would create for users of financial statements.

Non-controlling interests are restricted to certain subsidiaries, whereas the controlling interests are affected by the performance of the entire group. Then, we believe that non-controlling interests are a specific kind of equity and remain a third party to the group.

Furthermore, the treatment proposed is in contradiction with the proposed amendment of IAS 21 (§48) which requires that the proportionate share of the related accumulated foreign exchange difference is recognised in profit and loss when a sale of controlling-interests occurs.

Therefore, we recommend that gains and losses on decreases of interests continue to be recognised in profit or loss even if control still exists.

- Remaining non-controlling equity investment on the date control is lost (Question 2 of invitation to comment on IAS 27 ED):

Where the residual interest is an associate or a jointly controlled entity, we disagree that the remaining non-controlling interest should be measured at fair value, because it is inconsistent with the standards (IAS 28 or IAS 31) applicable to the investment.

Where the residual non controlling interest is classified as “available for sale” in accordance to IAS 39, we agree that it should be measured at fair value. However, the impact of remeasurement should be accounted for in equity rather then in profit or loss.

Therefore, we strongly recommend keeping the existing principle unchanged on this matter.

- Transitional provisions (Question 5 of invitation to comment to IAS 27 ED):

IFRS 3 states that the full goodwill approach should be applied prospectively and IAS 27 requires a retrospective application except for § 30A, 30C and 30D that should be applied prospectively.

That means that IAS 27 § 30B (that states that the non-controlling interest in the subsidiary's net assets comprises that portion of the subsidiary's goodwill, if any, allocated to the non-controlling interest) should be applied retrospectively which is inconsistent with IFRS 3.

We identify this inconsistency even though we suggest to suppress the full goodwill approach.

In conclusion, while we support the objective of international convergence, we strongly think that standards that have been in force for a while should not be modified before both preparers and users as well as auditors have fully appropriated these standards and before lessons may be drawn from sufficient experience.

That especially applies to standards which are part of the so-called “2005 Stable Platform” (cf IASB web site) and which have been applied for the first time in Europe by 2005.
We also believe that before considering conceptual changes in recognition and measurement, like those proposed in the exposure-drafts of amendments to IFRS 3, IAS 27 and IAS 37, additional analysis should be performed in liaison with major conceptual studies that the Board has undertaken and with other projects under consideration.

Only indispensable amendments should be proposed in the near future. With regard to IFRS 3 and IAS 27, we suggest that amendments should be limited in the short term to accounting treatments for:

- previously acquired non-controlling equity investment on the date the control is obtained,
- increases and decreases of interests after control is obtained, on the basis of the view that we have described above.

With respect to provisions and liabilities, we would raise the risk of possible inconsistencies between the Insurance contracts Phase II project and proposed amendments to recognition and measurement in IAS 37.

We remain at your disposal to discuss our comments.

Yours sincerely

Sophie Massol
Group financial policy officer

Jacques Le Douit
Accounting research and development director