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Sir David Tweedie, Chairman
IAS Board
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National Institute for the Supervision and Promotion of Cooperatives (INFOCOOP)
National Council of Cooperatives (CONACOOB)
San José, Costa Rica
Ref: IFRS3 « Business Combinations » consultation
To the International Accounting Standard Board -IASB

**COMMENTS BY THE COSTA RICA INSTITUTE FOR THE PROMOTION OF
COOPERATIVES – INFOCOOP- and
THE COSTA RICA NATIONAL COUNCIL
OF COOPERATIVES – CONACOOB-
ON THE IASB'S 2005 EXPOSURE DRAFT ON AMENDMENTS TO THE
"IFRS 3 – BUSINESS COMBINATIONS"**

The COSTA RICA INSTITUTE FOR THE PROMOTION OF COOPERATIVES – **INFOCOOP-** and the NATIONAL COUNCIL OF COOPERATIVES, **CONACOOB** of Costa Rica, after having analysed the IASB draft put to consultation on the « IFRS 3 Business Combination" » that includes the concept of « Mutual Entity » within its scope, and having considered the negative impact that such proposal may imply for cooperative entities, remit the annexed document containing the observations based on the official position shared by both the national organism of supervision of cooperatives in Costa Rica- INFOCOOP- and the national Council of Cooperatives -CONACOOB, with the purpose that these be considered by the IASB.

Yours sincerely,

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GENERAL OBSERVATIONS ON THE DRAFT

In view of the public consultation starting in June of 2005 that proposes the definitive inclusion of “mutual entities” into the IFRS3, the following observations are to be considered:

1. There shall be the obligation to use the concept of “fair value” in the accounting of the combinations of companies among which the “mutual entities”, while up to now, the book value has been the practice, observed as an accounting principle among the cooperatives. While the book value is based on historical figures and reflects the economic reality of the business done between the members and the cooperative, the fair value is based on future expectations of profit that is useful to external investors. It does not consider the social value of the cooperative or its value added for the community in which the cooperative is embedded.
2. It is not clear whether the interests of the members in a “mutual entity” are considered transferable since the IASB declares that “the interests of the members of a mutual entity are not generally transferable”. Yet, on the other hand, the interests of members are described as transferable in an “example” of assets to be calculated as part of “the fair value of the consideration transferred in exchange in favour of the acquirer’s interest in the acquired one.”
3. The “method of purchase” is transformed into the “method of acquisition” to also cover intangible assets. The IASB appears to consider the relationships with clients like intangible assets, also declaring that “mutual entities” are made up of members that are at the same time clients / customers and owners. Consequently, according to the IFRS3, the member’s participation in a cooperative may be sold at its fair value and as an intangible.
4. The proposed text establishes clearly that the relationship after the acquisition there is vertical control, namely that of a motherhouse to a subsidiary. The text also suggests that any type of entity could acquire a cooperative including its members like client’s relationships, even through a hostile takeover.
5. The document also clarifies that “regulatory concerns” on the application of the method of acquisition to the mutual entities, are not to be considered.
6. Concerning the concept of “mutual entities” as interpreted by the IASB, cooperatives are included without sufficient clarity on their true conceptualization and it includes the following definition: a mutual entity is an entity which is the property of investors that provides dividends, lower costs, or other economic benefits directly and proportionally to its owners, members, or participants. In the absence of any other central function, the “mutual entities” appear as characterized exclusively by the proportionate provision of economic benefits to their members. This situation is contrary to the will of participation of an associated member into a cooperative who essentially seeks the service that the cooperative can offer him/her and a solution to common needs without the will for profit.

SPECIFIC COMMENTS ON THE CONCEPT OF MUTUAL ENTITY AND COOPERATIVE ENTITY

Next, some elements are enumerated to distinguish and demonstrate that the characteristic nature and meaning of “cooperative entity” does not correspond to the concept of “mutual entity” as emitted by the IASB:

- a. The Recommendation 193 of the ILO on the Promotion of Cooperatives, approved in the International Labour Conference of the year 2002 by nearly all governments, employer organizations and labour unions, incorporates the complete Declaration about the Cooperative Identity that had been agreed in the worldwide assembly of the International Cooperative Alliance (ACI) and their whole membership in Manchester in 1995. These are the standards of the cooperative entity.
- b. According to the definition given in the ILO Recommendation 193, a cooperative is in the first place “an association of persons”. If we combine this concept with the first cooperative principle (voluntary and open admission) as it has been explained in the same ILO Recommendation (“The cooperatives are voluntary organizations, open to all persons capable of using their services and willing to accept the responsibilities of being a member”), the cooperative is an open association that does not appear in the IASB concept of “mutual entity”.
- c. A cooperative is “an autonomous association of persons united voluntarily to satisfy their common economic, social and cultural needs and aspirations through an enterprise of joint property and of democratic management” (Recommendation 193 on the Promotion of the Cooperatives).
- d. The entrepreneurial nature of the cooperative (“through an enterprise”) is explicitly instrumental. The objective of the cooperative is that their associates can satisfy their economic, social and cultural needs and aspirations in common”, and not the distribution of “dividends according to the stock capital, like it happens in ‘sociedades anonimas’, capital companies, or other forms of benefits as defined by the IASB for the “mutual entity”, although the cooperative through its entrepreneurial function requires to be as competitive as possible in any market economy. Their incorporation as entity of the “social economy” allows for the development of the less favoured and for the fair distribution of wealth. At the same time, the ILO Recommendation also underlines the entrepreneurial aspect of the cooperative affirming that the cooperatives operate in all sectors of the economy.
- e. As far as entrepreneurial governance is concerned, the cooperative is “of joint property, and of democratic management”. Those concepts united to the second cooperative principle (democratic management on the part of the members”) in the text of the ILO Recommendation 193 reflects that the cooperatives are organizations democratically managed by the members with equal right of vote (one member- one vote) “, independently of the amount of social capital contributed by the members. If the cooperative was mainly managed and focused on the distribution of dividends according to the stock capital or other forms of benefits like it is supposed for “mutual entities”, it would be surprising to see the cooperative business practice in the entire world of “a member, a vote”.
- f. Concerning the distribution of surpluses, of utmost relevance to the present discussion, the ILO Recommendation 193 mentions the fourth cooperative principle (the members’

economic participation”) according to which “the members contribute equally to the capital of their cooperatives and manage it in a democratic way”, stating that part of such capital is common property of the cooperative”.

- g. The fourth cooperative principle clarifies that members receive compensation, if any, according to the capital contributed as condition to be member.” The common practice is the equivalent of a bank interest, with the purpose of avoiding the depreciation of the participation, in order to maintain its nominal value. On the assignment of surpluses, the associates assign the surpluses to all or some of the following goals: the development of their cooperative in general by means of the establishment of reserves, of which a part at least it would be irrepartible that is indivisible or non-distributive; after which members may receive a benefit in proportion to their operations with their grassroots cooperative; and to support other activities approved by the same members.
- h. As we can see, the assignment of surpluses to benefit cooperative members in proportion to their operations with their grassroots cooperative, the only part of the whole IASB draft about the cooperative identity that appear to be included within the definition of “mutual entity”, does not fundamentally match because:

- The surplus concept in a cooperative is different from the concept of “dividends on the basis of contribution” or other benefits given to ordinary owner-clients in a “mutual entity”. In the latter, like in any conventional company, such benefits seems to be an inherent right of the owner, while in a cooperative the assignment of surpluses to the members is only a possibility defined by the cooperative through its general assembly.
- The assignment of surpluses in a cooperative is not a “gain” like it has been described under the concept of “mutual entity”, but rather an adjustment, declared at the end of the accounting period, dedicated to compensate the members for the surcharges they had paid before when using the services received in reason of its operations with the cooperative entity. It is for this reason that those surpluses are usually the object of taxation imposed to the members as individuals, but not to the cooperative itself.

It should also be indicated that the surpluses are distributed only partly since a part of them, the most substantial part, is usually dedicated to the reserves, to the development of the cooperative, or other beneficial activities to the community in general. In particular, when the cooperative also provides goods or services to third parties that are not associated, the surplus of such activities is usually destined to indivisible reserves and educative goals. Instead, the IASB “mutual entity” seems to allocate profit exclusively to the owners of capital.

- Dividends, in their very essence, are not an objective of the cooperative. The objective, as stated in the very definition of “cooperative” is to satisfy the common economic, social and cultural needs and aspirations of persons.
- i. Members do not join a cooperative to make a profit, because if that were their purpose they would rather invest in other options specifically oriented to that end, such as acquiring shares of a conventional enterprise in the expectation of the highest possible profits (which, as the IASB draft seems to recognize, is not the case of a cooperative, looking forward to make economies, to save, to be efficient, to satisfy a common need and so on).
- j. On the contrary, the main motivation of persons with “cooperative interest” is to join together with other members into a cooperative association with a common goal towards the

satisfaction of common needs and aspirations, be it social; economic or cultural or a mix of them.

k. Regarding the IASB statement that “the interests of the members of a mutual entity generally include a right to share in the net assets of the mutual entity in the event of liquidation or conversion”, it is clearly not the case in many parts of the world where part of the surplus is allocated to reserves that are “indivisible”, namely that they are ‘not-shareable’ - cannot be divided or shared or distributed, including in the event of liquidation. That part can neither be a source of “dividends” that result from the act of dividing.

l. Another major cooperative principle is absent from the IASB concept of “mutual entity”: namely that “cooperatives work for the sustainable development of their local communities” by means of policies approved by their members. (Seventh cooperative principle: interest for the community, Recommendation 193 of the ILO.).

m. In the first place, being open to all (first cooperative principle), the cooperative has the mission of including a growing part of the local community gradually. Second, when important cooperative are able to expand along the years using part of their surpluses intensely for the development of the local communities in which they are embedded; they do it because they are not guided toward the speculative remuneration of capital, but rather they necessarily assign a substantial part of their surpluses to the local community. In this sense, when they reach such goals, the cooperatives turn into powerful engines and multipliers of local development.

CONCLUSIONS AND REQUEST TO THE IAS BOARD

In conformity with the previous considerations, it is immediately requested:

1. The definitive exclusion of cooperatives from IFRS3.
2. To emphasize that the “mutual entities” and the “cooperative entities” are different, in function of their very essence, their nature and the ends they pursue.
3. In reason of the Recommendation 193 emitted by the ILO, an independent category should be defined in order to apply the international standards of Financial Information to cooperative entities that take into account their true nature.