Confederación Empresarial Española de la Economía Social C/ Vallehermoso, 15 – 1°. E28015-Madrid (España)

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Sir David Tweedie, Chairman IAS Board 30 Cannon Sreet UK – London EC4M6XH

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COMMENTS OF "CEPES" ON THE IASB'S EXPOSURE DRAFT ON AMENDMENTS TO "IFRS 3 – BUSINESS COMBINATIONS"

CEPES (The Spanish Business Confederation of the Social Economy) was created en 1992 to serve as the main institutional representative of the Social Economy in Spain.

This Confederation is composed of 23 member partners that are organized in the different autonomous regions through more that 200 support structures. The Social Economy operates in all the economic sectors through more than 48,000 companies, and had a yearly turnover in 2004 of more than 87 billion euros, accounting for over 7% of the Gross Domestic Product. It represents more than 2 million jobs and almost 10 million citizens.

The 23 partners that make up CEPES are the main representatives of the different "families" of the Social Economy (cooperatives, labour societies, mutualities, sheltered employment centres and social insertion companies) and are present in all the sectors of the economy.

General Remarks:

CEPES is pleased to provide the IASB with its comments regarding the 2005 IASB's exposure draft on amendments to "IFRS 3 – Business Combinations". We take note that this exposure draft continues with its intention of including "mutual entities", a term that appears to include mutuals and cooperatives.

Following the analysis of all responses to the 2004 IASB consultation on the inclusion of the "mutual entities" within the IFRS3, CEPES reminds the IASB that 78,6% of all respondents rejected the inclusion of "mutual entities", out of which all business economic actors, and that this rejection was not only a matter of timing or retroactive application but one related to the nature of the entity and the way business is done by such entity. Consequently, based on the due process, the 2005 proposed inclusion of cooperatives and mutuals into the IFRS3 should not proceed.

The definition of "mutual entity" that emerges from the exposure draft is in blatant contradiction with the internationally-agreed cooperative definition and principles, and with the way in which cooperatives function around the world. We object to the IASB



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proposed definition as the concept is unclear in its boundaries and mixes different business structures that cannot be accounted for in the same manner.

Moreover, CEPES is convinced that business combinations among mutuals and cooperatives cannot be properly accounted for under the present proposal. To our understanding the very nature of cooperatives and of mutuals is incompatible with an obligation to use the "purchase" method in business combinations.

Consequently, CEPES encourages the IASB not to go ahead with its intention of including mutuals and cooperatives within the scope of the standard and to defer this decision until a more adequate method could be found in the third phase of the business combinations project.

Detailed remarks:

Along the text, there are only examples, such as "mutual insurance companies" "mutual co-operative entities", (BC 184, p 54), "credit unions" (BC 182), a "wholesale buying cooperative" (ibid) etc. The fact of giving only partial examples makes the limits of what is included into "mutual entities" unclear: nowhere does the IASB state that "mutual entities" are exclusively composed of cooperatives and mutuals, nor that they are composed of all cooperatives and mutuals, nor that they may also be composed of other types of enterprises or not.

Furthermore, there is a main difference between the two entities (cooperative and mutual) as cooperatives issue member shares but mutuals do not. For mutuals, their difference with the IAS Board's "mutual entity" concept is even clearer: mutuals have neither nominal nor transferable shares whatsoever. Membership in a mutual is often(but not systematically) granted upon payment of a fixed entry fee which does not carry any right to the member and is never negotiable.

The objective of the cooperative per se is for its members "to meet their common economic, social and cultural needs and aspirations", not the distribution of dividends or other forms of benefits as the IASB's "mutual entity" concept appears to imply, even though the cooperative, through its entrepreneurial function, obviously needs to be as competitive as possible in the market economy.

As we can see, the allocation of surpluses to 'benefiting members in proportion to their transactions with the cooperative", the only part of the whole statement on the cooperative identity which appears to be included in the definition of a "mutual entity" as it emerges from the Exposure Draft, fundamentally differs from such definition because:

- Under the "mutual entity" concept, the benefits appear to be an inherent right of
 the owners and not to be submitted to any particular limit, as is the case in any
 conventional business, whereas in a cooperative the allocation of dividends to
 members is only a possibility defined by the cooperative itself through its
 general assembly, and in any case is always limited.
- The allocation of dividends in a cooperative is not a "gain" nor a "profit" as
 described under the "mutual entity" concept, but only an adjustment aimed to



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compensate the members for what they paid in excess or received less in their transactions with the cooperative. It is for this reason that those dividends are generally taxed to the cooperative members as individuals, not to the cooperative.

- Distributing dividends is not part of the objectives of a cooperative, which in turn are stated in the definition of cooperative ("to meet their common economic, social and cultural needs and aspirations"). Indeed, since the owners are also the users (a more appropriate term than the more commercial term of "customers" used in the Exposure Draft to define "mutual entity" members), it is difficult to understand why their objective in the cooperative would be to generate lucrative profits on their own transactions with the cooperative, and then redistribute such profits among themselves later. Members do not join a cooperative in order to make a lucrative profit out of the dividends, because if that was the case they could make other investments that would be specifically oriented to this end, such as the acquisition of shares in a conventional profitoriented enterprise.
- Concerning the IASB's consideration that "interests of members of a mutual entity ... usually include a right to share in the net assets of the mutual entity in the event of its liquidation or conversion", it is obvious that this cannot be the case in the many countries of the world (eg an important part of EU countries, Latin America, India, Africa etc.) where part of the surpluses are allocated to reserves that are indivisible even in case of liquidation or conversion.

While it can be agreed that some mergers between cooperatives or mutuals could fit the criteria set out for the purchase method, i.e. the identification of an acquirer and of control over an acquiree, we are convinced that in many mergers this will not be the case. There may will be many situations which are true mergers or at least where an acquirer cannot be identified and no definitive control is exerted by one entity over another.

Finally, CEPES would like to recall that the intrinsic value of the membership in a mutual or cooperative comprises financial as well as non-financial advantages. Consequently, the notion of fair value, which makes sense for investors, seems illadapted to such types of companies.

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