Cooperativa de Producción y Trabajo VENCEDOR

NIT. 860.522.164-1



October 25, 2005

Sir David Tweedie Chairman IAS Board 30 Cannon Street UK- London EC4M6XH

Letter of Comment No: 154 File Reference: 1204-001

COMMENTS ON THE IASB'S EXPOSURE DRAFT of 2005 ON AMENDMENTS TO "IFRS 3 – BUSINESS COMBINATIONS"

As the legal representative of the Workers and Production Cooperative VENCEDOR, organization based in Bogotá, Colombia, with activities in the poultry industry, specifically in the production of chicken meat, in which the 400 associates are at the same time the workers, I express our comments with respect to the project of 2005, exposed by the IAS council about the amendments to the IFRS – 3 – Business Combinations, on the intention of including "mutual entities", a term that appears to include mutuals and cooperatives.

First of all, we have to consider 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.

We are convinced that the combinations among mutuals and cooperatives cannot be properly accounted for under the present proposal, nor that an entity can acquire a cooperative as explained under the proposed amendments.

Based on our analysis,

- We request the definitive exclusion of cooperatives and mutuals from IFRS3 (on which there is a wide consensus within the cooperative movement already as we saw in the consultation last year) and, instead, the <u>utilization of the "pooling of interest" method</u>; technical arguments can be found in last year's communications and in section 2 of this document. Furthermore, after the request for exclusion last year by 78,8% of all respondents, the due process has not been really complied with.
- We strongly emphasize that cooperatives and mutuals do not correspond to the concept of "mutual entities" as described along the exposure draft, nor with the wider concept of "profit oriented entities" which exclusively includes conventional

- enterprises and "mutual entities", and therefore requests that the internationally-agreed distinctive characteristics of cooperatives and mutuals be clearly recognized.
- We underline the fact that the technical knowledge is still lacking and the need of rethinking a distinctive accounting category for cooperatives, as described in ILO Recommendation 193. This category could be common with mutuals provided that the differences between the two models are explicitly clarified, and provided that this common category is clearly different from the present "mutual entity" concept.
- We propose the establishment of a specific working group on this topic with the participation of experts on accounting specialised in cooperatives and mutuals from around the world.

Comments:

1) Business entity concept and appropriate accounting treatment: We object to the IASB proposed definition of mutual entity, as the concept is unclear in its boundaries between mutuals and cooperatives, mixing different business structures that cannot be accounted for in the same manner.

Cooperatives issue member shares but mutuals do not. For mutuals, their difference with the IAS Board's "mutual entity" concept is even clearer: mutuals DON'T have nominal nor transferable shares whatsoever. The number of members in a mutual is often (but not systematically) granted upon payment of a fixed fee which does not carry any right to the member and is never negotiable.

Cooperatives and mutuals have been internationally defined. Cooperatives already have world standards of their own. According to the Statement on the Cooperative Identity, agreed upon by the International Cooperative Alliance and its entire world membership in Manchester in 1995, and incorporated in full in International Labour Organisation Recommendation 193 on the Promotion of Cooperatives, approved at the 2002 session of the International Labour Conference of the ILO in Geneva by all governments, employers' organisations and trade unions¹, defines the cooperative as "an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise".

Therefore, a cooperative is, first of all, as "an association of persons", not of capital, its entrepreneurial nature being explicitly instrumental ("through a enterprise"), a fundamental characteristic which does not appear so far in the IASB concept of "mutual entity". 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.

A cooperative is "jointly owned and democratically controlled". (one member one vote)", irrespective of the amount of financial involvement of the different members.

Except for the abstention of one government and one employers' organization. In total, 128 governments (including, among others, the USA, Canada, all 25 present EU member states, and Japan), 94 national employers' organizations and 107 national trade union organisations voted in favour.

In terms of redistribution of surpluses, the aspect of highest relevance in the present discussion, the fourth cooperative principle (members' economic participation) stipulates that "members contribute equitably to, and democratically control, the capital of their cooperative", part of such capital being the "common property" of the cooperative, and that "members usually receive <u>limited</u> compensation, <u>if any</u>, on capital subscribed as a condition of membership" (underlining added).

It is important to add that, on the basis of the above-mentioned characteristics, the emerging global policy framework around cooperatives is clearly based on that universally accepted Statement on Co-operative Identity. ILO Recommendation 193/2002 on the Promotion of Cooperatives formulates a whole policy framework at the world level. The ILO has also stated that "Co-operatives have proved to be a key organisational form in building new models to combat social exclusion and poverty.

Justification of Different Treatment

- The IASB affirms that "the unique attributes of mutual entities were not sufficient to justify an accounting treatment different from that provided for other entities", developed also in BC 180-183. There are fundamental characteristics which distinguish mutual and cooperative societies from capital companies and thus objects to this statement.
- A mutual or a cooperative society is "controlled" collectively by its members insofar as the latter (or their delegates) elect its executive directors at the general assembly according to the "one person, one vote" principle, not according to the amount of shares or any other voting system.
- With regard to BC 180 a, mutuals and cooperatives provide their members not only with financial but above all with non-financial advantages.
- 2) Acquisition and resulting control under a relationship of mother-subsidiary applied to cooperatives: The new definition of business combinations given in IFRS 3 relies on the premise that an entity takes over or holds the control of another one. This entails that for every merger, the acquisition method should be applied and that, consequently, an acquirer should in each case be identified.

According to the new definition that emerges in the Exposure Draft, the "purchase method" has become the "acquisition method" in order to cover intangible assets. The IASB considers customer relationships as intangible assets, and declares that "mutual entities" are composed of members who are both customers and owners². The main difference between "mutual entities" and conventional businesses, according to the IAS Board, is that the owners are also customers (a commercial relationship with a different meaning from "users"). According to the IAS Board, the owners of a "mutual entity" will supposedly either seek the payment of dividends (as a fixed-term investor in any conventional business) or a reduction of the cost of what they buy (as any customer) or both.

The new draft clearly states that the relationship after acquisition is one of control, namely of parent to subsidiary. A new paragraph to IFRS3 is even being proposed on how to settle the acquisition date of a hostile takeover³. Although "mutual entities" are not mentioned in

² op. cit, A25, p. 61

^{3 &}quot;In the case of a hostile takeover, the earliest date that a substantive agreement between the combining parties is reached is the date that a sufficient number of the acquiree's owners have accepted the

this particular paragraph, it appears to apply to them as well. It is not clear whether the members' interests in a "mutual entity" are considered to be transferable or not.

To sell its business, a cooperative must be first terminated as an association of persons by the democratic sovereign decision of its general assembly. Only after its necessary conversion into a capital company, the business can be sold. At this stage, what is being sold is not the cooperative (which exists no more) but a conventional capital company. This is why cooperatives cannot be included in the scope of IFRS3.

Concerning becoming a subsidiary, this is not possible for a cooperative, as it must be democratically controlled in a sovereign manner through the one-person-one-vote in its general assembly. Otherwise, it is simply not a cooperative.

Regarding the identification of the acquirer in a merger among two cooperatives, and taking into account the above paragraph, it could still be possible in some cases to identify an acquirer. But in many mergers this shall probably not be the case. There are many true mergers in particular in the sense that no definitive control is exerted by one entity over another. Owners are the same before and after the combination and they remain with equal powers and control of the combined venture. This, as the cooperative world definition clearly states, is closer to the idea of a joint venture. As we all know, joint ventures have a working group that has not yet issued conclusions and so far they are excluded from the scope of IFRS3.

3) The use of fair value in accounting "business combinations" between "mutual entities": The book value has so far been the most widespread type of accounting value among cooperatives because book value it is based on historical figures, while fair value is based on future hypotheses and is useful to external investors, which is irrelevant for cooperatives.

Furthermore, the IAS Board in the document uses 'fair value' to cover a range of measurements, resulting in a diversity of methods which shall result in neither comparability nor standardization. In itself, this is a weak point of the draft, and therefore one worthy of concern. The various types of measurement proposed all have in common a speculative approach which is not functional to cooperative needs⁴. As cooperative shares are not transferable, and since members are not looking for the maximum possible profit, the exercise of fair value is not meaningful. And as almost all cooperatives in the world are not listed at the stock market, information is basically for the members, not for external agents such as stockmarket investors and analysts.

acquirer's offer for the acquirer to obtain control of the acquire" (op. cit, BC, proposal of amendment to paragraph 139. p, 121)

⁴ Those approaches include the "income approach" (discounting future cash flows) which is neither verifiable nor objective, and involves speculation about future amounts, speculation about their timing, and speculation about the rate at which to discount them; the cost approach which is also concerned with speculation or expectations about the future – what it might cost to acquire a substitute asset of "comparable utility" after speculating further about its obsolescence; and the fair value to be estimated "with significant entity inputs", reportedly one of the reasons why Enron's financial reports proved to be so unreliable.

Finally, the 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 ill-adapted to cooperatives and mutuals. Cooperative accounting should among other issues take into account the various components of the value of membership.

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