



Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Brussels, 27th October 2005
MR/B16/05/9547

CommentLetters@iasb.org

Letter of Comment No: 212
File Reference: 1204-001

Re: EACB comments on IASB Exposure Draft on amendments to IFRS 3

Dear Sir David,

The European Association of Co-operative Banks (EACB)¹ has considered the IASB's Exposure Draft on amendments to "IFRS 3 – Business Combinations", which has been issued in the context of the IASB's and FASB's joint project, and is pleased to comment on the document.

The Exposure draft intends to repeal the previous scope exclusions from IFRS 3 of mergers amongst mutuals. Consequently, mergers amongst mutuals would have to be accounted for by applying the purchase method.

We underline that this method does not reflect the true and fair view of cooperative mergers, which usually are mergers among equals and not take-overs. A cooperative cannot be acquired; they are instead merged with every member having an equal voting right in the new entity. The accounting method used for this type of operation is usually the pooling method, often prescribed by national legislation.

Furthermore, we would like to state that even if the purchase method were to be applied, it does not appear to be adapted to mergers between cooperatives. In a few cases, an acquirer could possibly be identified in mergers of cooperatives according to the methodology proposed by the IASB. However, we reiterate that in many other merger situations among cooperatives, we expect that it will be not only difficult but also nearly impossible to qualify an acquirer and therefore to apply the purchase method. This is consistent with the views of our comment letter dated 29th July 2004 on the previous Exposure Draft on "IFRS 3 –

¹ The European Association of Co-operative Banks represents over 4,500 co-operative credit institutions active in all the EU Member states and serving over 100 Million customers. Its member organisations are decentralised national networks of small-sized Co-operative banks' networks, which have a strong presence on a local or regional level. They account for a large part of the SME and private household credit market (17%) and thus play a crucial role within the Internal Market.



Business Combinations - Combinations by Contract Alone or involving Mutual Entities”. As far as no acquirer can be identified, the use of the purchase method would lead to almost arbitrary effects on the financial statements. The application of the purchase method in those cases would thus not reflect the economic reality.

We therefore suggest that the IASB maintain the scope exclusion from the standard for those mergers among cooperatives, where no acquirer can be identified until an alternative method, which would take those specific cases into consideration, is developed in the next phase of the business combinations project.

Our detailed responses to the questions raised in the Exposure Draft are set out below.

Yours sincerely,

Volker HEEGEMANN
Senior Adviser

Marcel ROY
Adviser



Appendix

Question 1

Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception and what alternative do you suggest?

Specific aspects of the Exposure Draft:

Under BC 180, the Board argues that “*the unique attributes of mutual entities were not sufficient to justify an accounting treatment different from that provided for other entities.*” The Board argues furthermore that argument of difficulties with regard to identifying the acquirer and the fact that there was no payment of reliably measurable consideration could also be applied to other types of entities, reason for which there was no justification for any specific guidance or exception for mutuals.

In BC 30-32, the IASB agrees with FASB that “true mergers”, defined as mergers where one party does not gain control over the other subsequent to the business combination, were so rare that they did not warrant a separate accounting treatment. Consequently, the boards have decided to include all business combinations, even those where there is no real notion of control of one entity over the other, into the scope of IFRS 3. The IASB however states that it might consider the fresh start method in future reviews of the standard.

Paragraph 53 of the Exposure draft states the following guidance for recognition and measurement with regard to mergers amongst mutuals:

“In a business combination involving only mutual entities in which the only consideration exchanged is the member interest of the acquiree for the member interest of the acquirer (or the member interest of the newly combined entity), the amount equal to the fair value of the acquiree shall be recognised as a direct addition to capital or equity, not retained earnings.”

Comments by the EACB:

As a preliminary comment, we would like to underline the fact that in our understanding, it appears that the concept of “mutual entity” is used interchangeably to mean mutual and cooperative entity. For clarity’s sake, we would like to point out that there is a substantial difference between the two concepts, as mutual do not issue formal member shares whereas cooperative banks do. This difference has to be borne in mind when reviewing existing or drafting future standards.

The previous phase of the business combinations project had concluded that mergers among mutuals were to remain excluded from the scope of IFRS 3, pending a solution to be found subsequently. While this new exposure draft argues that such mergers could now be accounted for under IFRS 3, the EACB is not convinced by the case for repealing the scope exclusion for all types of business combinations between mutuals.



We would like to attract the Board's attention to the fundamental difference between mergers of Stock-listed companies on one hand and mergers between cooperative entities on the other. While in Stock-listed companies, the fair valuation of the companies' assets is necessary to decide on the bidding price and in order to protect the financial interests of the shareholders, the situation is different in the case of cooperatives. The cooperative share is issued to the cooperative member at a fixed price. The claim to assets by the member is thus limited to the nominal amount of his share. The valuation of the assets has thus no direct bearing to the member, since he cannot access the cooperative's reserves. Due to the one-man, one-vote principle, the members have to decide democratically on the merger. Each member is equally represented in new cooperative, therefore decision cannot be influenced by single large shareholders and the member's economic rights are therefore ensured. This framework is typically anchored in national legislation.

In this context, the fair valuation and the purchase method do not seem to be adapted in what rather a pooling of interest than a take-over.

Furthermore, while it can certainly be argued that in some business combinations between mutual entities acquirers could be technically identified according to the criteria suggested by the IASB, in which case the accounting treatment under Paragraph 53 could be applicable, it is less certain that an acquirer can be readily identified for a majority of merger situations between mutuals.

Despite the dispositions under Paragraph 12, we expect that in the context of ongoing consolidation of the banking sector at national level, there will many borderline cases in merger situations between small local cooperative banks, where either "true mergers" occur or where at least control cannot be positively established and an acquirer cannot be identified. Choosing an acquirer then will become an arbitrary choice, which could lead to quite diverging results, depending on which entity is labelled as being the "acquirer".

As such borderline cases are expected to be more prevalent among cooperatives than other entities, it is the EACB's perception that a scope exclusion is warranted for those mergers between mutuals, where no acquirer can be identified, until a better accounting alternative can be developed. In the meantime, arbitrary accounting results could be avoided by the reinstatement of the pooling of interest method.

Finally, the EACB is looking forward to contributing to the dialogue with the IASB and FASB in the future regarding the development of any alternative method to the purchase method in order to ensure that such a method be neutral to all company forms, including cooperatives.