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Sir David Tweedie, Chairman
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**COMMENTS OF ECG ON THE IASB EXPOSURE DRAFT of 2005 ON
AMENDMENTS TO "IFRS 3 – BUSINESS COMBINATIONS"**

ECG represents European cooperative groups, such as MCC Mondragon Corporacion Cooperativa, CGM Consorzio Gino Mattarelli per la ooperazione Sociale, GECV Grupo Empresarial Cooperativo Valenciano, CCPL Consorzio Cooperativo Produzione e Lavoro, the Groupe Crédit Coopératif, the Groupe Crédit Mutuel and the CNS Consorzio Nazionale di Servizi.

General Remarks:

ECG is pleased to provide the IASB with its comments regarding the 2005 IASB's exposure draft on amendments to "IFRS 3 – Business Combinations", a follow up draft to last year's business combinations project phase I, which reaffirms the proposal for including mutuals and cooperatives within the scope of the standard under the concept of "mutual entities".

First of all, following the 2004 IASB consultation on the inclusion of the "mutual entities" within the IFRS3 and all the responses received by the IASB in 2004, ECG recalls that 78,6% of responses rejected such inclusion on the basis of various technical arguments, out of which all business organisations.

ECG believes that business combinations among mutuals and cooperatives may not be adequately accounted for under the present proposal. ECG thus insists the IASB to find a more adequate method during the third phase of the business combinations project. ECG also recommends that all stakeholders be consulted over any future method.

Detailed remarks:

1) Business entity accounting treatment

- The IASB term “mutual entity” has no clear boundaries and mixes different business structures. The IASB uses 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 IASB never states the clear boundaries and definitive scope of “mutual entities”.

Cooperatives and mutuals differ in their capital formation: cooperatives issue member shares; mutuals do not. Mutuals’ difference with the IAS Board’s “mutual entity” concept is strong: mutuals have neither nominal nor transferable shares.

Beyond, the description of the term “mutual entity” does not match that of a cooperative. According to the International Cooperative Alliance and its entire world membership in Manchester in 1995, later incorporated in full in the 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 unions present¹, the cooperative is “*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*” (para 2). These fundamental characteristics do not appear so far in the IASB concept of “mutual entity”.

- 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. As seen above, ECG would like remind the IASB that there are fundamental characteristics which distinguish mutual and cooperative societies from capital companies.

In terms of corporate governance and control, the cooperative is “*jointly owned and democratically controlled*”. A cooperative society is “controlled” collectively by its members as the latter (or their delegates) designate its executive directors at the general assembly according to the “one person, one vote” principle. Those concepts are linked to the second cooperative principle (democratic member control), on which ILO Recommendation 193 adds that “*cooperatives are democratic organizations controlled by their members*” with “*equal voting rights (one member one vote)*”, irrespective of the amount of financial involvement of the different members.

- Under the “mutual entity” concept, the benefits appear to be an inherent right of the owners and like in any conventional business.

In relation to BC 180 a, mutuals and cooperatives provide their members not only with financial but above all with non-financial advantages (e.g. actions relevant for local community and socio-economic development, responses to poverty and exclusion; etc;).

- In turn, the IASB’s “mutual entity” appears to allocate profit exclusively to the capital owners.

Yet, 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.

¹ 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 unions voted in favour.

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 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 normally taxed to the cooperative members as individuals, not to the cooperative.

If dividends are distributed, it is only on the basis of the surpluses, the most substantial part of which is usually destined to reserves, the development of the cooperative, or other activities beneficial to the community at large. In particular, when the cooperative also provides goods or services to third parties that are not members, the surplus of such activities is often destined to indivisible reserves or educational activities.

In terms of redistribution of surpluses, 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 limited compensation, if any, on capital subscribed as a condition of membership*” (underlining added). The usual practice is the equivalent of a bank interest rate, in order to avoid the depreciation of the cooperative shares which otherwise remain at nominal value. Concerning the allocation of surpluses, “*members allocate surpluses for any or all of the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership*” (underlining added).

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*”).

The main motivation of members in joining a cooperative is to obtain, together with other members, the satisfaction of a specific need, according to the type of cooperative, such as creating employment, building their own housing, accessing credit, ensuring access to food of quality at the most reasonable cost, accessing electricity in marginalized and rural, ensuring a fairer income to individual farmers through joint commercialization of their products, etc.

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 an important part of EU countries, where part of the surpluses are allocated to reserves that are indivisible even in case of liquidation or conversion.

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, in each case an acquirer should be identified.
- 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. Indeed, the main difference

² op. cit, A25, p. 61

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 this particular paragraph, it appears to apply to them as well, especially if we take into account the following sentence: *“For example, an entity acquiring a co-operative entity should consider the value of the member discounts in its determination of fair value”*⁴. “An entity” means any entity; It seems that any type of entity acquiring a cooperative including its members as customer relationships, even through a hostile takeover.
- It is not clear whether the members’ interests in a “mutual entity” are considered to be transferable or not: on the one hand, the IASB states that *“interests of members of a mutual entity generally are not transferable”*⁵; on the other hand, members’ interests are portrayed as transferable in an “example” of assets to be calculated as part of *“the fair value of the consideration transferred in exchange for the acquirer’s interest in the acquiree”*⁶.

Being an association of persons and not of capital, cooperative membership is nominal, and each person is free to associate and to leave the cooperative. In this sense; cooperative members’ shares cannot be sold as customers’ relationships. As an association of persons it cannot be sold as such. Only in the case of **non-members** business relationships there could be a conception of intangible assets. To sell its business, a cooperative must be first terminated as association of persons by the democratic sovereign decision of its general assembly. After its necessary conversion into a capital company, the business can be sold. At this stage, what is being sold is not the cooperative but a conventional capital company.

Concerning becoming a subsidiary, this is not possible for a cooperative as such, as it must be democratically controlled in a sovereign manner through the one-person-one-vote in its general assembly. Otherwise, it is not a cooperative. It may however, be merged in a merger of equals or its business sold after its termination and conversion. It may also enter into network and group relationships as a peer, partner, etc. but must always remain autonomous as its international definition clearly establishes.

Regarding the identification of acquirer in a merger among two cooperatives, it may be possible in some cases to identify an acquirer. But in many mergers this may not be the case. There are many true mergers in the sense that no definitive control is exerted by one entity over another. Owners are the

³ *“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 acquirer’s offer for the acquirer to obtain control of the acquiree”* (op. cit, BC, proposal of amendment to paragraph 139. p, 121)

⁴ op.cit, BC63, page 22

⁵ Exposure draft of proposed amendments to IFRS3 Business Combinations, June 2005, BC182 (b) p 54

⁶ op cit, Consideration Transferred 21 (a) p. 30 and A25 p. 61

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 as "jointly owned", is closer to the idea of joint venture. Within the IASB, joint ventures are so far excluded from the scope of IFRS3. Similarly, until a more appropriate accounting treatment may be found for cooperatives and mutuals; the pooling of interest should continue to be used in the case of these true mergers.

ECG strongly emphasises that "mutual entities" do not match to the concept of cooperatives as described along the exposure draft. Cooperatives must be recognized in all their characteristics fully and coherently in order to be properly accounted.

ECG proposes once more to the IASB the establishment of a specific working group on this issue with the participation of experts on accounting specialised in cooperatives and mutuals from around the world, and offers its support in the search for appropriate accounting treatment of cooperatives.



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