

COOPERATIVA ACAC

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Montevideo
Uruguay

28th July, 2004

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

Dear Sir David,

Comments on International Accounting Standards Board's (the IASB's) Exposure Draft - Amendments to IFRS 3 Business Combinations – “*Combinations by Contract Alone or Involving Mutual Entities*” (referred to as the proposed amendments).

We are pleased to comment on the proposed Amendments to IFRS 3.

The ED of Amendments to IFRS 3 plans to scoop in combinations by contract alone or involving mutual entities (cooperatives and mutuals). The Exposure Draft also intends to use a *different* method of purchase in such cases.

After analysing the proposal, we disagree with the Exposure Draft of amendments to IFRS3. Amendments to IFRS 3 are not appropriate to mutual entities, and do not reflect their juridical nature or their economic reality. We therefore suggest to the IAS Board to keep the IFRS 3 as approved in March 2004, only four months ago, and to continue applying the accounting method of “pooling of interest” to mutual entities until adequate guidelines are issued.

Eliminating the pooling of interest method and replacing it with a less appropriate one is no improvement as far as mutual entities are concerned. The proposed purchase or acquisition method applied to mutual entities raises many new questions.

Please allow us to insist on the specificity of the mutual entities compared to conventional enterprises, and in particular when treating their framework for co-operating through various ways (through a legal merger, a contractual arrangement, a cooperative of cooperatives and so on). While in the conventional enterprise shareholders look for “value creation”, namely the maximum shareholder value, in the cooperative and mutual world the objective is to optimise the services provided to members-owners of mutual entities.

By principle, the combination between mutual entities can never be conducted as a sale of the member shares (a 'share deal'). This is because the purpose of a cooperative is to “*meet [its members] common economic, social and cultural needs and aspirations*” (ILO Recommendation 193). In contrast to the purchase of the majority of common stock in a conventional corporation, the situation by which an acquirer obtains control by purchasing more than half of the voting rights cannot occur in mutual entities, because the principle of "one-person-one-vote" prohibits one person to take control of the majority of the voting rights. Member shares are not transferable to non-members. Moreover, member shares are issued and redeemed on a nominal basis, and therefore do not have a market value which an acquirer would

be willing to pay. Shares issued to members of the combined entity do not reflect any kind of purchase price or cost of the combination. Any kind of purchase method depending on measuring the cost of the combination leads to serious practical problems if applied on mutual entities (cooperatives and mutuals).

It is our conclusion to recommend the non-application of the Exposure Draft of amendments to IFRS. The proposed method shall create many practical problems, and moreover, as a temporary and incorrect solution, it is pre-empting a long-term solution that could lead to high quality accounting standards.

Yours sincerely,

Sr. Juan E. Daufin
Manager

Esc. José Luis Sarachu
President

Annex

Comments of COOPERATIVA ACAC on Proposed Amendments to IFRS 3 Business Combinations

Question 1

The Exposure Draft proposes:

(a) to remove from IFRS 3 the scope exclusions for business combinations involving two or more mutual entities and business combinations in which separate entities are brought together to form a reporting entity by contract alone without the obtaining of an ownership interests

(b) to require the acquirer to measure the cost of a business combination as:

i. the aggregate of the following amounts when the combination is one in which the acquirer and acquiree are both mutual entities:

the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities; and

the fair value, at the date of exchange, of any assets given, liabilities incurred or assumed, or equity instruments issued by the acquirer in exchange for control of the acquiree

Therefore, goodwill would be recognised in the accounting for such transactions only to the extent of any consideration given by the acquirer in exchange for the control of the acquiree.

ii. The net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities when the combination is one in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest. Therefore no goodwill would arise in the accounting for such transactions. Is this an appropriate interim solution to the accounting for such transactions until the Board develops guidance on applying the purchase method to such transactions as part of a subsequent phase of its Business Combinations project? If not, what other approaches would you recommend as an interim solution to the accounting for such transactions, and why?

It is indeed difficult to determine who is the acquirer and acquiree in the cases of mergers of cooperatives and/ or mutuals, as well as in the cases of contractual groups of cooperatives and/ or mutuals.

However, the main issue is not the difficulty to identify who should be the acquirer and acquiree, but the fact that due to the juridical nature of mutual entities, such legal figure of acquirer is not applicable

Members' shares in cooperatives and mutuals, when these do exist, are non-transferable and nominal, with all members enjoying equal voting rights. It is not possible to control a cooperative entity by purchasing the majority of its members' share capital (such shares are not transferable) and there are limits to members' voting power (principle of "one person one vote"), even if one member has more shares than another member.

In the case of contractual groups, their logic is of co-operation (co-operare) for specific socio-economic functions, and to ensure the long-term sustainability of the latter. When new cooperatives enter the group, they democratically decide to join in, in the same way as their founding members previously decided democratically to constitute the cooperative. Such joining in is motivated by a socio-economic function that the group performs. This can in no way be assimilated to a purchase, nor can it justify the utilisation of the purchase method.

Most Business Combinations of mutual entities, because of their very nature, may identify with the method of Pooling of Interest. The latter accounting method appears in conformity with

their specific nature and should remain in force for them until an alternative method that takes into account their specific legal nature and economic reality is found.

Nobody has been able so far to define an appropriate accounting methodology for the combinations of mutual entities, although there is the mention to “fresh start accounting”, a project that would start in the near future. The IASB should look at all alternatives, even others than the fresh start accounting, to find out an appropriate long-term solution that respects the legal nature of cooperatives and mutuals, and reflects their economic reality. We are ready to provide any information and to take part in any working group on this topic.

Question 2

The Exposure Draft proposes that no amendments be made to the transitional and effective date requirements in IFRS 3. This would have the effects set out in paragraph 6(a) – 6(c) above on the accounting for business combinations in which the acquirer and acquiree are both mutual entities or in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest.

Is this appropriate? If not, what transitional and effective date arrangements would you recommend for such business combinations and why?

The date proposed in the Exposure Draft means the retroactive application of the standard, something that is not legally acceptable.

The retroactive date of application, for a norm to be approved at the end of the year, when so many contracts among cooperatives and mutuals in the world will have to change in order to acquire each other, and with retroactive accounting, is neither legal, nor practical. It will be very costly, time consuming, and may bring up multiple legal court cases for contractual groups when deciding who is the acquirer, and most important, the method of purchase can reflect neither the juridical nature of cooperatives and mutuals nor the economic reality underneath. We believe that accounting is for providing accurate information to the members and public authorities, and that accounting cannot have the power to infringe upon the type of property and ownership of cooperatives' members. The type of property mutuals have must also be respected.

Hasty regulatory changes just four months after the approval in March of the IFRS 3, that might be possibly approved by the IASB at the end of 2004, provides neither time for adaptation (costly and time consuming) nor a stable regulatory environment that may deliver the benefits of trust and reliability.

The arrangement proposed is Interim (temporary) even though it may require changing laws in many countries in the world and statutory changes for cooperatives. Moreover, it would require changes to existing contracts among mutual entities all over the world. This is neither appropriate nor efficient. It also pre-empts the outcome of an adequate and stable solution for the long term.

Until the appropriate solutions are found, we recommend to continue with the pooling of interests and the net book value methods for mergers and contractual combinations among mutual entities (cooperatives and mutuals).