Ref: 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").

July 29th, 2004

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

Dear Sir David,

ECG is pleased to send its comments on the proposed Amendments to IFRS 3. **ECG strongly disagrees with the proposed amendments and recommends the non-application of both the IFRS 3 and its proposed amendments to the enterprises that the IASB has labelled as "mutual entities", i.e. cooperatives and mutuals. For technical arguments, please see the Annex.**

ECG presently associates 6 cooperative groups (Mondragon Corporacion Cooperativa, Groupe Crédit Mutuel, Consorzio Gino Mattarelli per la Cooperazione Sociale, Grup Empresarial Cooperatiu Valencia, Consorzio Cooperativo Produzione e Lavoro, Groupe Crédit Coopératif), with a combined total of 3000 enterprises (mostly SMEs) and around 150 000 workers, and a combined turnover of over 15 000 EURO. A **cooperative group** is distinct from a cooperative enterprise, and is also distinct from a conventional enterprise group. It is a particular strategic response of cooperative enterprises to the challenges of globalised competitiveness, allowing them to maintain their specific values, principles and socio-economic functions, whereas, until now, most of the attention has been paid to the group of conventional enterprises based on capital i.e., "*groups of subordination*".

It may be affirmed that the **cooperative group** enables its constituent enterprises to better develop their capabilities under forms such as the "***group of coordination***" and the "***peer group***". **The cooperative groups** are specific as compared to other types of groups of enterprises, due to the particular structure, values, principles, and functioning of cooperative enterprises. In particular, cooperative groups have a prominent role to play in the implementation of the 6th cooperative principle, namely "*cooperation among cooperatives*" (see ILO Recommendation 193/2002 on the Promotion of Cooperatives, art 3 and annex).

Given the complexity of the **contractual ties** that link their constituent enterprises, they are not a simple transposition of grassroots cooperative enterprises. In other words, they are not simply "cooperatives of cooperatives". Nor are they large cooperative enterprises built on mergers of smaller units, since **cooperative groups** comprise enterprises of any size: large, medium and even very small ones. They should also be clearly distinguished from representative associations of cooperatives, such as federations or confederations. Indeed**, cooperative groups** are entrepreneurial by nature, rather than representative

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organisations. Both types of structures (**cooperative groups** and cooperative associations) can co-exist and mutually reinforce each other. The innovative character of **cooperative groups** as compared to both cooperative enterprises and conventional enterprise groups logically requires specific legal and regulatory frameworks at all levels. Such legal frameworks need **to acknowledge the specific contractual ties and division of roles between the various levels and structures within the cooperative group**. It also needs to take into account their specific characteristics in terms of e.g. fiscal law and accountancy regulations that such specific ties generate.

In order to apply the method of acquisition as proposed in the IFRS 3 and its amendments, mutual entities would be obliged to transfer their cooperative members' shares to a head entity, by which control and power would be thereafter concentrated within that head entity. To do so, given that cooperative members' shares are nominal and non-transferable and that the group is made of equals, cooperatives would first have to be de-mutualised and converted into conventional enterprises with conventional types of shares, while the group would not remain as one of equals because the structure of power (decision-making and control) would be irreversibly altered. Such cases would then reflect the purchase of conventional enterprises by one head entity, and would therefore fall outside the scope of the proposed amendments (which refer to "*two or more mutual entities*").

Thus, the IFRS 3 amendments would neither be practicable nor reliable. The situation may thus be conducive to strong rejection of the standard that, last but not least, would be enforced on an **interim** basis. Therefore, we believe that the IASB should seriously consider the creation of a working group to explore and find out the appropriate accounting solution to these cases, without hurrying into changes to the IFRS 3, just passed in March 2004. The IASB should instead follow a similar path to the one it has justly chosen for joint ventures. ECG would gladly contribute to the understanding of the cooperative entrepreneurial groups, so that the IASB can delve into their diverse reality, different from the conventional business groups of "*subordinated character*".

An accountancy standard should reflect the true juridical and economic reality of this type of entrepreneurial inter-cooperation. To force such entrepreneurial groups that have been created through legal contracts entered by free will and as equals, and which must remain open and democratic by both their juridical nature and world standards (please see ICA 1995 standards incorporated into the ILO Recommendation 193 / 2002, voted by governments, business organisations and labour unions from the whole world), to renounce to their own existence as "mutual entities", can never be the legitimate substance or object of an accountancy standard.

Yours sincerely,

Bruno Roelants
Director

Annex
Comments of ECG on the 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?

As generally recognised, it is indeed difficult to determine who is the acquirer and acquiree in the cases of contractual peer groups of cooperatives. The reason for such difficulty is the fact that, due to the juridical nature of "mutual entities", such legal figure of acquirer is not applicable. Cooperatives shares are non-transferable and nominal, with all members enjoying equal voting rights. Hence, it is not possible to control a cooperative entity by purchasing the majority of member share capital (principle of "one man one vote"). Finally, it is not possible to account for an acquisition of a cooperative or to directly transfer its members' shares, at least not before the entity is de-mutualised, dissolved, and turned into a conventional enterprise.

In the case of contractual groups, there is no transaction taking place, but a contractual agreement between two parties to share certain assets and/or activities, based on democratic and voluntary decision-making. The result of a Business Combination of mutual entities is not the control of an entity onto another, but rather two or more entities which control, under conditions of equal power, certain assets and activities in common.

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Contractual groups of cooperatives lead to neither hierarchical control nor concentration of capital. Their logic is that of co-operation (*co-operare*) for specific socio-economic functions, and to ensure the long-term sustainability of the latter. When new members enter the group, in general they first create their own cooperative and then they democratically decide to join in. The latter case should not be a purchase. This is a main reason why contractual peer business combinations of mutual entities, because of their very nature, used to identify with the type of Business Combination that the IAS 22 considered as a Pooling of Interest. The latter accounting method appeared more in conformity with their specific nature.

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 juridical legal nature of cooperatives as well as reflects the economic reality of mutual entities. For this, we offer all our collaboration.

As far as the question on good will is concerned, there is definitely good will when two or more mutual entities engage in a cooperative merger. The issue at stake is not the existence of good will but its measurement and thus its recognition. The fact that it is difficult to achieve such measurement cannot lead to easily disregard its existence. The only fair solution is to dedicate the necessary efforts to study the problem and to find out an appropriate measurement methodology.

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 acceptable in our legal environments. Furthermore, the proposed amendments are Interim (temporary) and retroactive, while changes to both laws and contracts of peer groups would be required in many countries. This is neither appropriate nor efficient. It also forestalls the outcome of an adequate solution for the long term.

ECG would also like to call the attention to the due process of consultation, when the proposed amendments utilise key concepts whose contents and connotations are being redefined at this very moment by he IASB itself (e.g. business, control, consolidation, purchase and acquisition, good will). It would be more appropriate to work out guidelines on the basis of certain and clear concepts. In particular, when the solution offered is Interim.

ECG thus calls for the non-application of the IFRS 3 to mutual entities, proposing to continue with the method pooling of interests and the net book value methods for contractual combinations of mutual entities until adequate accounting solutions are found out and the legal time frame are set. In the meantime, as far as other accounting norms are still in *force*, there shall be no legal vacuum.