GVN

Genossenschaftsverband
Norddeutschland e.V.

Genossenschaftsverband Norddeutschland e.V.
Postfach 2120 • 30021 Hannover

Vorstand

Telefon 0511-95740
Telefax 0511-9574375
www.geno-verband.de

Email to: CommentLetters@iasb.org

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

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M-hn

Comments on Proposed Amendments to IFRS 3 Business Combinations

Dear Sir David,

we are pleased to have the opportunity to comment on the exposure draft "*Amendments to IFRS 3 Business Combinations: Combinations by Contract Alone or Involving Mutual Entities*". Cooperatives comprise the strongest form of economic organisation in Germany representing some 8,500 cooperatives with more than 20m. members.

Thousands of cooperatives in Germany have conducted legal mergers during the last decade and continue to do so in the future. Thus we place great importance on the issue of accounting for business combinations. Despite the fact that the application of IFRS yet is not mandatory to most cooperatives we observe an increasing number of voluntary IFRS users.

We fully disagree with the proposed amendments to IFRS 3. Thus we urge the Board to leave the standard IFRS 3 unchanged. In principle an acquisition is different from a uniting of interests according to the economic substance of the transactions. In our mind economic and legal differences justify a different accounting treatment. The exposure draft does not address the basis principles of business combinations between cooperatives (see Appendix).

In addition we are displeased with the IASB's strategy of drafting. The proposed changes shall be applicable as from an earlier date than the exposure draft has been published. Isolated from accounting details a retroactive amendment of IFRS 3 gives rise to reject the draft. The IASB should return to its previously announced strategy and exclude mutual and cooperative entities and combinations by contract alone from the scope of IFRS 3.

We offer our full support to the IASB in exploring the economic reality of business combinations between mutual or cooperative entities. Therefore we propose to the establish a working group on mutual and cooperative issues at the IASB. The very recent problems the IASB had in finding appropriate accounting rules for member shares in cooperative entities under IAS 32 revealed an instant need for closer cooperation with the addressed parties.

Sincerely,

Michael Bockelmann
(Wirtschaftsprüfer)

Horst Mathes
(Wirtschaftsprüfer)

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Principles of business combinations between cooperative entities:

- The intention of the members of the combining cooperatives is to continue their businesses by jointly sharing risks and rewards. According to that economic substance combinations equal the continuation of the two businesses in one legal entity in the hand of the combing members. In our opinion it is appropriate to account for as though the separate businesses were continuing as before, though now jointly owned and reported in a single financial statement. Accordingly, only minimal changes are needed in aggregating the individual financial statements.
- By principle, the combination between mutual entities can never be conducted by purchasing member shares (a 'share deal'). Members' shares are not transferable, tradable or fungible. Due to this fact it is not possible to obtain control in a cooperative entity by purchasing the majority of member share capital.
- The principle of "one-member-one-vote" prohibits to obtain or exercise control by one party. Thus combinations between cooperatives never result in a parent-subsidiary relation.
- Principle of nominal value of member shares: member shares are issued and redeemed on a nominal basis. Member shares do neither represent a proportionate share of the enterprise value (including goodwill) nor the net asset value of the enterprise (excluding goodwill). The value of the member shares always equals the paid in capital. Therefore they cannot be treated similar to shares in a corporation within the purchase method.
- No material purchase price is paid: combining cooperatives need not to evaluate their fair enterprise values similar to purchase agreements of investor owned companies. The purchase method in IFRS 3 – requiring to measure the cost of the acquired entity at the fair value of net assets transferred – does not reflect the economic substance of the combination between cooperatives and leads to practical implications.
- The users and preparers of financial statements of a cooperative entity are not comparable to investors of a publicly listed corporation. The advantage of additional information by measuring the acquired enterprise at fair values does not overweight the costs to obtain these values.

With respect to these facts German local law allows combining cooperatives as an alternative to carry forward book values or to conduct a revaluation. For most of cooperative entities, their members as well as for the users of their financial statements the enormous costs imposed by requirements to calculate fair values cannot outweigh the benefits that are intended. We believe that carrying forward book values is appropriate in almost all cases of combinations between cooperatives. The IFRS as worldwide applicable standards should not focus solely on the situation of listed corporations.

We don't see any principle under IFRS that strictly forbids the IASB to establish different accounting methods according to different economic circumstances. High quality reporting standards should always allow to reflect the economic substance of specific legal and economic facts and the needs of users of financial statements. Accordingly, the IASB should prescribe appropriate accounting methods for each in IFRS 3.

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Instead the IASB proposes to eliminate the pooling of interest method described in IAS 22. All combinations should be accounted for applying only one single method, the purchase method, modified for the application by mutuals and cooperatives. Accordingly combining cooperatives have to identify the entity acquiring the other. Assets, liabilities and even the contingent liabilities of the acquired entity have to be measured and accounted for at their fair values in the balances sheet of the acquirer.

The Board detected that mutuals and cooperatives normally do not pay any consideration and thus having a substantial problem in reliably measuring the cost of combination. But measuring the cost of the combination is the fundamental basis of applying the purchase method. In order to address this problem – on an interim basis until sound solutions are found – the exposure draft intends the creation of a 'special purchase method for mutuals' replacing the pooling method or other kinds of accounting on basis of carrying amounts. We doubt that this is the appropriate accounting strategy.

The IASB proposes to treat the fair value of shares issued to the transferring members as the price paid for taking over control – the 'control premium'. Additionally the amount of acquired goodwill shall be equal to this control premium paid – the fair value of issued shares.

We are really surprised about that creative way of accounting. In no way does this accounting method reflect the economic substance of a business combination, nor is that method supported by any accounting theory or academic fiction we are aware of nor is it practicable for cooperatives. Some facts may show this to you: 1) Control in a cooperative cannot be obtained by purchasing or issuing members shares; 2) the principle of shares being non tradable and the principle of nominal amounts of shares prohibit calculating fair values of member shares; 3) the amount of shares issued to new members equals the paid in capital – this amount is not linked to the amount of acquired goodwill.