World Council of Credit Unions, Inc.

July 30, 2004

Annette Kimmit
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Re: Comment Letter to IFRS 3 Amendment

Dear Ms. Kimmit,

As the apex trade association and development organization for the international credit union movement representing over 40,000 cooperatively owned not-for-profit credit unions in 84 countries and serving over 123 million owner-members worldwide, the World Council of Credit Unions, Inc. (WOCCU) submits the following comments on the International Accounting Standards Board Exposure Draft of proposed amendments to IFRS 3 Business Combinations.

Worldwide credit unions have over $758 billion in assets with over $656 billion in savings, $483 billion in loans and $75 billion in capital. Since approximately three percent (3%) of credit unions worldwide have been and continue to merge each year, this issue of business combinations is of acute interest to credit unions.

BACKGROUND

In the early part of 2001, the American and Canadian accounting authorities, the Financial Accounting Standards Board (FASB) and the Canadian Institute of Chartered Accountants (CICA), reached a bi-lateral agreement to eliminate the pooling of interests method and to implement the purchase method of accounting for business combinations. However following the adoption of the purchase method of accounting, both FASB and CICA deferred the implementation of the purchase method for mutual entities in the United States and Canada. In November 2003, FASB concluded that combinations of mutual enterprises are not sufficiently different from other combinations to warrant a different treatment of goodwill.

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On July 20, 2004, FASB announced a new timetable for its project on the accounting for mergers of mutuals. Initially FASB's proposed guidance was expected out for public comment in the third quarter of 2004 with a roundtable meeting planned in the fourth quarter of 2004. Now FASB will release its proposed guidance in the fourth quarter of 2004 with a roundtable meeting in the first quarter of 2005. The final rule is scheduled to be effective as of January 1, 2006. This delay will allow FASB constituents the opportunity to study the proposed changes to the accounting before the Exposure Draft is issued for public comment.

In July 2001, WOCCU expressed its concerns to the IASB in a letter addressed to Mr. Frank Palmer. In this 2001 correspondence, WOCCU voiced its concern with the application of the purchase method of accounting to credit union mergers. Subsequently in October 2003, WOCCU staff met with the lead staff of the IASB to provide the credit unions perspective on IFRS 3 Business Combinations. WOCCU urged IASB to recognize the unique nature of credit unions mergers and to take into account this nature when devising accounting standards for such mergers. In April 2004, IASB issued its Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations. This Exposure Draft proposes to include mutual entities within the scope of IFRS 3 and apply the purchase method of accounting to all mutual mergers dating from March 31, 2004 and beyond.

WOCCU'S CONCERNS WITH IFRS 3

WOCCU petitions the International Accounting Standards Board to recognize its concerns with the implementation of IFRS 3 to credit unions:

1. Undercapitalization

The inherent nature of the credit union structure is unique, because credit unions are not-for-profit entities owned and controlled by its members, all with an equal voice and equal vote. Also as part of this unique nature, member shares do not appreciate. As a result of this nature, individual credit union members do not financially gain during the merger of two credit unions and no consideration is exchanged. Consequently, credit unions do not have an incentive to negotiate a purchase price during a merger like other financial institutions.

Since price is not the ultimate focus of the negotiation, the acquisition of the merged credit union will likely occur at a price less than the "fair value" of the institution and simply at the par value of the acquiree's shares. Because the transaction price will typically be less than fair value, goodwill will result under IFRS 3. This creation of goodwill could adversely impact credit union mergers, because it will affect the ability of the acquirer from adding in the capital of the acquiree to retained earnings. Since the acquirer will be unable to add the capital of the acquiree to retained earnings, the acquirer credit union could be undercapitalized as a result of the merger under IFRS 3.

This undercapitalization could negatively impact credit unions in the following manner: First, the inability of the acquirer credit union to add the acquiree's capital will adversely impact the capital ratios of the acquiring credit union. Second, the undercapitalization will tend to discourage mergers, especially the merging of credit unions of equal size. Finally, this undercapitalization will exacerbate safety and soundness concerns, because regulators tend to "sell" the concept of merging a weaker credit union to healthy credit unions rather than closing the institution, the inability to add the full capital of the weaker institution into the healthy institution would make these mergers less frequent and result in more failures.

2. Regulatory Capital Recognition

In the United States, under a recent FASB opinion the retained earnings of the acquiree in a merger would be shown on the acquirer's books as a separate line item called "merged equity" instead of retained earnings. Unfortunately, the Federal Credit Union Act in the United States defines net worth for purpose of prompt corrective action (PCA) as "retained earnings" only. After a merger, not all of the GAAP (generally accepted accounting principles) equity of the acquirer credit union would count for purposes of PCA. Also under the Federal Credit Union Act, if a credit union's net worth ratio falls below the level mandated by statute, the credit union would be subject to regulatory action.

3. Retroactive Application

Assuming that IASB decides to apply IFRS 3 unconditionally to credit unions, WOCCU is concerned that the effective date of IFRS 3 would be an additional detriment to credit unions. Under the current IFRS 3 proposal, credit unions would be required to apply the revised version of IFRS 3 arising from the Exposure Draft to the accounting for all business combinations for which the agreement date is March 31, 2004 or later. Consequently, all credit union mergers would be subject to IFRS 3 if the agreement occurred in March 2004 or later, irrespective of the final amendment date to IFRS 3 for business combinations by the International Accounting Standards Board. This retroactive effective date would severely limit credit union mergers by requiring credit unions to adhere to the principles and procedures of IFRS 3 even when IFRS 3 was not officially recognized by the IASB. In addition, the retroactive application of IFRS 3 will severely punish credit unions that lack full knowledge or understanding of the implications of the Exposure Draft and engage in a merger during this period.

WOCCU'S PROPOSALS

WOCCU respectfully submits the following proposals regarding IFRS 3 to the International Accounting Standards Board:

1. Permit Pooling Method of Accounting for Credit Unions

Although WOCCU acknowledges the benefits of the purchase method of accounting for financial institutions, WOCCU would prefer that the purchase method of accounting not be required for the merger of credit unions.

2. Allow Credit Unions to Add Full Value of Capital to Retained Earnings in a Merger

In the alternative, WOCCU proposes that the IASB allow credit unions to add the full value of the acquiree's capital during a merger to retained earnings, regardless of the difference between the transaction price and the fair value. By permitting the full amount of the acquiree's capital to be added to the acquirer's capital as retained earnings during a credit union merger, undercapitalization will not occur and capital ratios will not be impacted.

3. Create Consistent Net Worth

WOCCU advocates that the IASB take the initiative to ensure that the net worth of the acquiring credit union be consistent with regulatory net worth and economic reality.

4. Eliminate Retroactive Application

If the IASB regretfully concludes that IFRS 3 should apply unconditionally to all credit unions, WOCCU alternatively proposes the IASB revise of the effective application of IFRS 3. Instead of the retroactive effective date of IFRS 3, WOCCU proposes a transition period be established before credit unions would be subject to the provisions in IFRS 3. WOCCU's believes this transition period should be one-year from the full annual accounting period after which IASB accepts the proposed amendments to IFRS 3. This transition period would enable credit unions sufficient time to evaluate their merger proposals and agreements to determine if such mergers would be beneficial in the face of the implementation of IFRS 3.

Thank you for your consideration of this issue in advance and please feel free to contact myself or Dave Grace at 608.231.8494 or via email at dgrace@woccu.org. I look forward to your response.

Sincerely,

Arthur Arnold
President and CEO