European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

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

Brussels, 29th July 2004
VH/B16/04/8946

CommentLetters@iasb.org

E-MAIL

Re: EACB comments on ED on IFRS 3

Dear Sir David,

The European Association of Cooperative Banks (EACB)[1] has considered the IASB's Exposure Draft on "IFRS 3 – Business Combinations – Combinations by Contract Alone or involving Mutual Entities" and is pleased to comment on the document.

Generally speaking, we suggest that the cooperative sector should not be included within the scope of IFRS 3 before further studies have been conducted on the matter.

We have to emphasize that there are merger situations – particularly among the types of combinations subject to this exposure draft – where it is not only difficult but also nearly impossible to qualify an acquirer and therefore to justify the purchase method. As far as no acquirer can be identified, the use of the purchase method leads to almost arbitrary effects on the financial statements. We therefore suggest that the IASB maintain the pooling of interests-method under IAS 22 and look into developing an alternative method, which would take the specificities of cooperatives into consideration.

Our detailed responses to the questions raised in the Exposure Draft are set out below.

Yours sincerely,

Hervé GUIDER
Secretary General

[1] The European Association of Co-operative Banks represents over 4.500 co-operative credit institutions active in all the EU Member states and serving over 100 Million customers. Its member organisations are decentralised national networks of small-sized Co-operative banks' networks, which have a strong presence on a local or regional level. They account for a large part of the SME and private household credit market (17%) and thus play a crucial role within the Internal Market.

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Appendix

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 interest.

(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 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 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 approach would you recommend as an interim solution to the accounting for such transactions, and why?

Response:

ED Proposed Amendments to IFRS 3 is an extension of the scope of the only recently issued IFRS 3 *Business Combinations*. We understand that the Board was not fully satisfied with the lack of solutions in IFRS 3 (as published on 31 March 2004) for the two types of combinations subject to this exposure draft.

In most countries cooperative banks mergers today are performed under the pooling of interest accounting methodology, which allows the balance sheets of the merging entities to be added together. However, with a worldwide move to fair-value accounting and the requirement to ascertain the fair value of both merging entities there is a willingness to recognize the difference between the fair value of the acquired entity and the value at which the transaction occurred and to utilize the purchase method of accounting for mergers. For most commercial entities any difference between the fair value and the actual negotiated price would be reflected as either positive or negative goodwill on the income statement.

In cooperative banks, there generally is not any consideration exchanged in mergers beyond the equalization of member share prices. As a result any difference between the fair value of an acquired cooperative bank and the price that the transaction occurred at (the book value of existing membership shares) does not represent either an error or good deal by the acquiring cooperative bank, but rather a function of our cooperative structure. At the core of the issue is that acquiring institutions should be able to recognize this difference between the fair value of the acquire institution and the acquisition price as a credit to the acquirer's equity.

When combinations are effected by contract alone or between mutual entities, it is difficult to estimate the cost of the combination and the goodwill acquired. The amount of any assets given, liabilities incurred or assumed or equity instruments issued by the acquirer in exchange for control of the acquiree is difficult to distinguish. It is therefore unrealistic that each merger will identify any goodwill. Furthermore, due to its legal statutes, a cooperative cannot be sold. Its only prospect of external growth lies in its realignment with another cooperative. In this perspective, the purpose of revaluing it at fair value appears questionable.

We also have to emphasize that there are merger situations – particularly among the types of combinations subject to this exposure draft – where it is not only difficult but also nearly impossible to qualify an acquirer and therefore to justify the purchase method. Business combinations involving mutual or cooperative entities frequently consist in forming a new entity in which member interests of the combining entities are brought together with no entity obtaining control over the others. Rather, the exchange of member interest usually entails an equal reapportioning of the combining organisation's board representation. In those cases, no acquirer can be identified. As far as no acquirer can be identified, the use of the purchase method leads to almost arbitrary effects on the financial statements. There could also be a situation where the acquiree's share of equity instruments in the combined entity could be greater after being fair valued than that of the acquirer.

Also, we attract the Board's attention to the fact that from a practical point of view, the application of the purchase method and the resulting fair value measurement of assets and liabilities will lead to disproportionate costs for business combinations of small mutuals. Indeed, characteristically, mergers between cooperative banks usually do not involve large entities, but rather smaller cooperative banks within one cooperative association, which are on equal footing and with an intent of pooling of interests.

We therefore urge the Board to consider an alternative accounting method for business combinations for cases where the purchase method is not appropriate, as is the case for the entities concerned by this amendment. However, we believe that the IASB should not focus only on the fresh start method but rather investigate solutions, which would allow taking into consideration the specificities of cooperatives. In the meantime, we suggest that the Board maintain the current status quo, continuing the use of the pooling of interests-method under IAS 22 until a satisfactory solution could be found.

We do not subscribe to the proposal to recognise as an expense the costs directly attributable to a combination. We, then, support EFRAG comments to point out that §31 B of the exposure draft is inconsistent with the IFRS 3 § 24 and 29. In those paragraphs such costs are included in the cost of the business combination and, accordingly, in the amount of goodwill arising on the acquisition.

One way to address this issue would be to consider that, as transactions costs are incurred as a necessary part of completing the combination, they should be accounted for as part of the transaction to which they relate. The initial accounting for the combination will lead to recognise the net fair value of the identifiable assets acquired as a change in acquirer's equity. Then, one possible solution could be to account for transactions costs that relate to that change as a deduction from equity.

We do not agree with the board's interim solution for the accounting of business combination involving entities that are brought together by contract only (e.g. Dual listed corporations). Another method, in which the enterprise value of the target entity is the value of the consideration, could be considered. That method is based on the underlying assumption that the value of the acquired entity approximates the market value of the quoted equity instruments. Under that method, and to be consistent with paragraph 24 and 29 of IFRS 3, determining the cost of combination would include the cost directly attributable (e.g. professional fees paid to accountants, lawyers…).

In addition, we wish to draw attention to the following issue. The acquiree may have recently acquired entities and, as the result of those combinations, may have recognised goodwill in its own consolidated financial statements. We have the impression that when determining the cost of business combination, the application of the provisions as defined by the Exposure Draft would lead to account for such combination at a value that does not include those goodwills and consequently at an amount that does not reflect the financial position of the acquiree. We therefore ask the Board to look at this issue and to give additional guidance.

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)-(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?

Response:

ED Proposed Amendments to IFRS 3 proposes the same transitional and effective date requirements as IFRS 3. We appreciate that IASB's intention was to avoid the application of different accounting methods for business combinations of such types, which could be the case if the exposure draft had a later effective date than IFRS 3.

However, we have serious reservations with the approach of introducing new standards or amendments to existing standards, which have an effective date even before the date of publication of the relevant exposure draft.

We are therefore seriously concerned that entities could be faced with a situation where decisions made under certain assumptions based on current accounting requirements would have been made differently if the change of accounting requirements – having a retrospective application date – would have been available at that date. In order to make sure that entities are able to have a stable set of standards and interpretations at the moment when decisions, e.g. with regard to a business combination, have to be made, we strongly urge the Board not to backdate the application date of standards as a principle. In particular the information and data necessary to map the merger may not be available, consequently the financial statements published cannot be reliable insofar.