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Comments of [Koimburi Tucker &Muya] on Proposed Amendments to IFRS 3 Business Combinations

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Date: 31-07-04

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
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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. We are a firm of accountants who have a consulting interest in cooperatives and have received your ED from the regional office of the International Cooperative alliance Nairobi, Kenya.

We strictly reject

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?

Responses to question 1

Member's shares in cooperatives and mutuals are not subscribed for resale but rather to show intention to be bound by the mutual bond of the cooperative values and principles as enshrined in the International Statement of Cooperative Identity.The ethos behind these values and principles of cooperatives are not entirely profit oriented but rather social-economic.

There are practical difficulties of defining acquirer and acquire amongst mutuals and cooperatives due to the fact that share capital is in most cases not legally defined in a typical instrument like the memorandum and articles of association as found in secular companies but rather falls under the ambit of the relevant law i.e the Cooperative Societies Act, and the aformentioned values and principles.

The concept of "one man one vote" regardless of the number of shares one has in a mutual or cooperatives makes it difficulty to define ownership necessary for regular decision making process.

The national laws governing co-operatives in several countries like Kenya provide for the setting up of 25% statutory reserves out each years profits and this may not be distributed in any way and therefore these reserves of the entity is not transferable in any case.

Most combinations of cooperatives in developing countries are meant to improve efficiencies and enhancing governance and not for purely commercial reasons and therefore the concept of one party being the acquirer does not arise and in any case is not meant to result in transfer of shares or dissolving of properties, and inverting control in one head unit due to the above mentioned one person one vote, and the principle of mutuality.

The other reason that cooperatives in third world get together is for the provision of services and sharing of the same i.e accountancy, audit , legal and IT.This is because many of the cooperatives have had declining performance due to global trading trends and liberalisation policies that have been sanctioned on the parent country by bilateral and multilateral agencies resulting in significant drop in earning capacity. Such combinations do not result in transfer of property and or dissolving of the same or legal notification of the same to a notary.

There are capacity problems in the national regulators (local institutes) some of whom are only a few years old and are struggling to have members understand the requirements of the IFRS for the regular companies let alone the specialized reporting entities like mutuals and cooperatives. the entities themselves do not have qualified or experienced staff to embrace the requirements of this proposed amendments to IFRS 3.

There are difficulties of ascertaining fair values in the mutuals and cooperatives as the shares are not transferable and the absence of an active market of these shares. There are costs involved in valuing these assets coupled with a shortage of professionals qualified to do the valuations in the entities in the developing world, and the directors may not have the competency of the market information to give them valuations.

Most mutuals in the developing nations, due to the relatively low GDP per head, only qualify to be categorised as SMEs and it can only be misleading and burdensome to immediately impose the full rigours of IFRS with no due regard to capacity of national regulators and the industry competency.

Because of the above reasons and the relative ease of application we are of the opinion that the pooling of interest is the best form of accounting for the combinations of mutuals and cooperatives. this is especially so in the developing countries where there are capacity gaps within the accounting regulators and the industry itself arising form the fact that most of the bodies are understaffed and were only recently started and do not have as yet the calibre of staff who would be able to embrace rapid changes of the IASB, not to the rationale behind such combinations in the rare occasions when they occur.

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?

Responses to question 2

We understand that this would be a retroactive application of the removal of the exclusion clause for mutuals from the IFRS 3 which for the entities in the developing world would be extremely damaging seeing that there is no evidence that the same has been shared by cooperatives in any forum. Retroactive application of the standard can only elicit rejection especially from a position of total ignorance.

There seems to be a heightened urgency in the IASB improvements projects perhaps to beat the EU deadline for 2005 in regard to the listed entities but in the process this may place heavy burdens of implementation of the IFRS within the developing nations whose problems may take years to undo.

As there is a project for the drafting of a standard of SMEs which we will cover the 3rd tier of SMEs who have a significant public interest which it would seem would include cooperatives it may be an idea to include cooperatives and mutuals in this abbreviated standards project after incorporating the views of cooperative and mutuals practitioners and other interested players in the sector to advise the projects team at the IASB.

The legal implications of the proposed changes are immense as this would include changing some laws which within the legislative calendars of the developing nations may take very long time.This could compromise relationships between the IASB on one hand the national regulators on the other and the respective governments.

In conclusion we suggest the non-application of the IFRS 3 to mutual entities including cooperatives and instead propose dialogue with the industry players and practitioners to work out a suitable accounting and reporting framework and perhaps the first place to start would be the ongoing project of the abbreviated SME reporting framework which we understand IASB is currently working on.Meanwhile we request the pooling of interest method be allowed to stay on for the cooperatives and mutuals business combinations.

yours faithfully

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