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From: wmatters@cpscu.com.au [mailto:wmatters@cpscu.com.au]
Sent: Thursday, 20 October 2005 11:08 AM
To: standard@aasb.com.au
Subject: Comments on ED 139: Business Combinations

Dear Sir/Madam

I am the CFO of CPS Credit Union (SA) Limited and have followed with much interest the recent developments in the area of Business Combinations with a particular eye on the implications for mutual entities. As with much of the regulatory environment, particularly in Australia, mutual entities like credit unions, often seem to either slip between the cracks or be shoe-horned into regulations that don't suit their structure or operating principles at all.

The Australian Credit Union industry is in a period of significant consolidation with many mergers currently taking place. Just last week, Credit Union Australia and Australian National Credit Union announced an intention to merge to form a $5bn mutual retail financial services provider. CPS Credit Union (SA) Limited is also in the midst of progressing a merger with our sister credit union CPS Credit Union Co-operative (ACT) Limited and so any Business Combination accounting changes arising from ED 139 will have direct application to us. Consequently, my comments set out below are specifically directed at mutual entity implications.

By way of background, mergers between Approved Deposit-taking Institutions (ADI's) in Australia are effected under the Financial Sector (Transfers of Business) Act 1999 (the Act). Sections 22 and 23 of this legislation describe the effect of voluntary transfers (mergers) and, inter alia, state that "all the assets and liabilities of the transferring body.....become (respectively) assets and liabilities of the receiving body without any transfer, conveyance or assignment", "the duties, obligations, immunities, rights and privileges applying to the transferring body apply to the receiving body", "each translated instrument (e.g. contracts) continues to have effect....as if a reference in the instrument to the transferring body were a reference to the receiving body" and "the terms and conditions of employment (including any accrued entitlement to employment benefits)" for transferring body staff are not affected by the transfer. I suggest that transfers under this Act are genuine mergers and clearly not in the nature of an "acquisition" and that the selection of transferring and receiving bodies is usually based simply on the option that will provide the most advantageous outcome for the merged entity.

Specific comments on ED 139 issues, in the context of mutual ADI mergers, are as set out below.

The Fair Value approach

Credit unions are not listed and there is no active market for their purchase/sale. Because there is no consideration "paid" in connection with mutual ADI mergers, ED 139 will require alternative valuation methods to be adopted in determining the fair value of the transferring body. Any such valuation would, at best, provide an indicative business value only which, in my opinion, would be sufficiently unreliable for use in measuring goodwill to be recognised in the financial statements. For mutual ADI mergers, such goodwill is likely to be significant (50% to 100%) relative to the value of net assets assumed. I contend that recognising such a quantum of goodwill as an outcome of a genuine merger would add little value to the financial statements and be misleading, no matter the quantum of associated note disclosures, for their principle users (being the credit union's members).

Recognising the fair value of assets and liabilities "acquired"

Recognising the assets and liabilities of the transferring body at fair value in the financial statements of the receiving body does not reflect the nature of the underlying transaction. The Act explicitly states that no transfer, conveyance or assignment occurs. These assets and liabilities simply 'become' the assets and liabilities of the merged entity. In addition, these assets and liabilities 'assumed' would then be measured on a different basis to the identical assets and liabilities of the receiving body, creating two classes of assets and liabilities in the merged entity. I contend that their recognition in accordance with the accounting policies of the merged entity (i.e. essentially at their carrying value in the accounts of the transferring entity measured in accordance with applicable Accounting Standards) would better reflect the substance of the transaction and provide a much more meaningful result for the principle users of the merged entity's financial statements.

No consideration

With no consideration being paid under the merger, ED 139 will result in the creation of a reserve in equity equal to the assessed fair value of the transferring entity. As purported earlier, such a valuation would not be reliable and may be significant relative to "real" owners' equity. For example, a credit union with a calculated fair value of, say, $80m could transfer to another credit union with net assets of, say $20m, with the ultimate merged credit union's equity being 80% comprised of a meaningless merger-related reserve. A more meaningful approach would be to simply record the net assets/equity (at book value) of the transferring entity directly against the equity of the receiving body as this better reflect the substance of the transaction.

Acquisition Costs

I hold significant reservations about the ED 139 proposal for acquisition costs to be expensed. In my opinion, this does not reflect the economic substance of an acquisition transaction (where the buyer would factor these costs into their purchase offer) and is inconsistent with the approach adopted in other accounting standards for asset acquisitions. Such an approach could easily lead to misleading volatility in an entity's reported earnings. For credit unions, this approach would be a merger deterrent because the, potentially significant, costs of the merger would immediately reduce reported profits but the benefits of the merger would be achieved over ensuing years. I contend that a better approach would be for acquisition costs to be treated as part of consideration for a 'traditional' business acquisition and, in respect of a merger of mutuals, be offset against the amount taken directly to equity in the receiving body (being the book value of equity of the transferring body) as there is no consideration paid.

In summary, I appreciate that my comments are very entity specific but feel that it is important that the implications for the credit union sector be properly considered. I would be happy to discuss these matters with you further should you wish.

Yours faithfully

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