P(08)4889:2

Brussels, 25 July 2008

EFRAG
13-14 Avenue des Arts
1210 BRUSSELS

RE: COGECA's contribution to PAAinE's Discussion Paper: DISTINGUISHING BETWEEN LIABILITY AND EQUITY

Dear Madam,

Dear Sir,

COGECA welcomes the initiative of the European Financial Reporting Advisory Group (EFRAG) and the European National Standard Setters of having established the Proactive Accounting Activities in Europe (PAAinE) that contributes to the global accounting standards debate.

It is from our side of utmost importance that Europe is engaged in the standard setting process and the convergence project driven by the International Accounting Standards Board (ISAB) and the US Financial Accounting Standards Board (FASB).

European agri-cooperatives lead the world in providing high quality food, while combating climate change and applying strict environmental protection standards. A vital role in this long standing achievement is attributed to the valuable social and economic synergies embedded in the co-operative model of enterprises.

At the same time, agricultural cooperatives worldwide, respond to the increasing competitive pressure imposed by globalization and structural changes in the food system, by pursuing competitive strategies such as value-added processing, brand name development, and entry into international markets, which require substantial capital investments/ equity contribution. Thus, it is vital for cooperatives as well, to attract and engage capital with much the same effectiveness it is achieved by Investor owned Firms (IoFs).

Within a cooperative structure, farmers' collective objective is primarily: to optimise all possible benefits for their farm businesses, thus mainly pursuing farm income maximisation.

Despite the differences characterizing ownership rights in the various forms of enterprises, <u>the fundamental feature of the institution of ownership</u> (namely its two distinct concepts: ***residual claims*** and ***residual right of control***[1], <u>carries an equally high importance, despite</u>

[1] "***Residual claims*** are defined as the rights to the net income generated by the firm – i.e., the amount left over after all promised payments to fixed claim holders"

<u>the difference traits, of the respective different ownership structure</u>s. Thus, the institution of ownership is considered as the most effective mechanism of providing economic agents with appropriate incentives to create, maintain and improve assets.

The profit seeking corporation (open, or public, or IoFs), is characterized by unrestricted residual claims that are non- redeemable but freely tradable among investors in secondary equity capital markets. The horizon of residual claims is unlimited because they are rights in net cash flows for the life of the organization. In addition, residual claimants are not required to play any other function in the firm.

The unrestricted nature of common stock residual claims enables the efficient allocation of risk and the specialization of risk bearing and decision-making functions in open corporations.

The traditional cooperative structure is defined as having the following property rights attributes: ownership rights are restricted to member-patrons; residual return rights are non-transferable, non-appreciable and redeemable; and benefits are distributed to members in proportion to patronage. These are restrictions on residual claim, usually added on co-operatives, in contrast to open corporations, that may affect asset investment and its use.

As a result of this property rights structure, traditional cooperatives are subject to investment and governance constraints. Such a governance constraint in cooperatives, usually occurs when patrons/ members of the board/ have to asses their executive management performance, as subject to multiple criteria, imposed both at the level of their farm (where their primary interests are vested), but at the level of the co-operative firm as well. Such governance constraints are not existent in open corporations, us performance is assessed by the single profit maximization criterion.

To sum up, the nature of cooperatives is not correctly reflected by IASB when they assume that an economic player acts solely under the premises to draw a maximum return from an economic undertaking and to pass this return back to its shareholders. This so-called "ownership" approach does not leave enough room to integrate also other legal forms or structures of companies.

COGECA agrees, in principle, that the general purpose of financial reporting is to provide correct and adequate information to all its capital providers, rather than reporting from the perspective of a particular class of capital providers. Nevertheless, we cannot neglect the fact that the basic ownership approach, complies with the needs of only a particular type of capital providers – a investors. On the other hand, co-operative shareholders, as explained above, do not (necessarily) share the same interests with profit seeking capital providers. Thus, the financial reporting needs of co-operative capital providers are not adequately met through the ownership approach.

IAS 32 regards the economic substance of the membership in a cooperative as a liability. According to IAS 32 cooperative shares are regarded as liabilities because they are redeemable to the members of a cooperative. The member/holder has the right to return his shares to the issuer/cooperative for cash or for another financial asset. This principle applies even if the shares confer the holder a right to a residual interest in the assets of the cooperative.

The Loss-Absorption Approach overcomes these obstacles as it recognizes capital as equity when it could cover also loses. Meaningful information could be provided to creditors.

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and
"***Residual rights of control*** are defined as the rights to make any decision regarding the use of an asset that is not explicitly attenuated by law or assigned to other parties by contract"

COGECA clearly raises its deep concern about the suggested approaches by the IASB for the distinction between liability and equity. In this approach cooperative membership shares are regarded as liabilities. In view of this, COGECA favors PAAinE's Loss-Absorption-Approach which due to its flexibility suits different legal forms of company.

The IASB and FASB approach for the distinction between liability and equity will lead cooperatives to abandon their "cooperative principles" and erase the respective provisions from their statutes. They will be forced to restructure their internal organisation by shifting into a different type of enterprise (e.g. IoF). This will effectively represent the loss of their social added value.

Cooperatives existing limitations in accessing financing would suffer additional restrictions and become less competitive. Such an event will have dramatic adverse effects in rural economies.

Kind regards,

Pekka PESONEN
Secretary General