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Geneva, 28 July 2008

Dear Sir/Madam,

On behalf of the international co-operative community of 800 million members, we are writing to you to comment on the discussion paper "distinguishing between liabilities and equity" and its potential impacts on co-operative businesses.

The International Co-operative Alliance (ICA), established in 1895, is an association of 220 national co-operatives in 87 countries. Our members are highly concerned about the adoption of new international accounting standards and their impact on the co-operative model of business.

Co-operatives – a significant part of the global economy

The co-operative sector represents a significant contribution to our global economy. According to the ICA annual survey, *Global 300*, the top 300 co-operatives around the world had nearly $1 trillion in revenues in 2005. That is only slightly less than the economy of the world's ninth largest economy, Canada. Co-operatives create over 100 million jobs, more than all of the multinational corporations combined. Co-operative enterprises also contribute to every sector of the economy and are among the largest businesses in the world.

The main characteristics of co-operative member shares

As co-operatives are member-owned businesses, their equity is provided by their members. A co-operative member will make an equity investment, often nominal, in a co-operative upon becoming a member. This investment represents a member's ownership interest in the co-operative.

Although co-operative legislation/s can be very different from one country to another, co-operative member shares have common characteristics.

Member shares are recognised by members as risk capital. In the unfortunate incidence of a bankruptcy, member shares participate in losses if the co-operative's own funds (which are usually comprised of retained earnings) cannot cover the losses.

In most cases, there is no active market for co-operative shares. The member's interest is generally not transferable and shares can only be exchanged with the co-operative itself. Unlike publicly held investor-owned entities, an individual or business typically can join a co-operative only after meeting the requirements for membership and after approval of the Board of Directors, or in some cases, the membership.

Co-operatives have a variety of arrangements regarding the redemption of members' shares or the refund of equity interest: in some countries or sectors, co-operative boards of directors have the

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unconditional right to refuse the redemption of the members' shares, in other countries or sectors, the co-operative has an obligation to redeem the members' shares or refund equity interests when a member decides to withdraw from the co-operative or when he is excluded from the co-operative.

Some co-operatives repurchase the shares of members or refund the equity interest upon their withdrawal from the co-operative, upon death, upon reaching retirement or a certain age. The redemption amount is generally limited to the book value of the member's shares. Other co-operatives have a policy of revolving equity of the co-operative over a period of time once specific equity levels are achieved or if the financial condition of the co-operative allows it.

The Loss Absorption Approach applied to Co-operatives

Though co-operatives function differently around the globe, their basic structure is similar and needs to be recognised by relevant accounting standards.

The "loss absorption approach" has potential appeal to co-operatives around the globe because co-operative member shares would be classified as equity regardless of any other consideration (redemption conditions, claims on the net assets at liquidation, etc…).
Indeed, co-operative member shares would be classified as equity under the loss absorption approach whereas they may not be under the FASB ownership approach or the IASB IFRIC 2 approach.

The EFRAG "loss absorption approach" holds promise not only for co-operatives, but for all businesses that operate with at risk capital. It takes into consideration both investors' interests and the concerns of non-listed companies, in particular co-operatives. This approach provides a broader range of users with decision-useful information concerning entities in different legal forms across different jurisdictions.

The "loss absorption approach" appears to be consistent with a principles-based approach **--** the principle being that capital available to absorb losses is ownership capital – and it is simple.

As a consequence, we fully support this approach which is very promising for co-operatives and which would lead, if it were adopted by the international accounting standard setters, to an appropriate accounting classification of co-operative member shares.

We look forward to working with EFRAG to ensure that international accounting standards take into account the needs of the international co-operative community.

Yours sincerely,

Ivano Barberini
President

Annex: *Replies to the invitation to comment*

Replies to the invitation to comment

Question 1
Do you believe that defining two different classes of capital on the credit side of the balance sheet does provide decision-useful information, even if the entity's capital structure is in fact multi-dimensional (the so-called "list claims"-approach, pars. 1.3ff.)? If not, why?

Defining two different classes of capital on the credit side of the balance sheet (equity and liabilities) does provide decision-useful information for users.

Defining more than two classes of capital would lead to create multiple categories of claims, with multiple definitions and multiple lines to draw between the different classes of capital, which would increase complexity and would not improve the understanding of the balance sheet for external users.

Question 2
Do you believe that listing all claims to the entity's assets, ranking those claims by a certain criterion and providing additional information on all other characteristics of the claims in the Notes to the financial statements would have merit (pars. 1.3 ff)? Why? If not, why?

The answer depends on the criterion which would be used to rank the claims on the balance sheet (the level of subordination seems to be a proper one). In this case, this approach would have some merit, as it would be less simplistic and more accurate than an approach with two classes of capital only (liabilities and equity).

On the other hand, this approach would lead to completely abandon the distinction between equity and liabilities and would constitute a complete revolution in our accounting representation of capital structures. An impact study would be required to test this approach on empirical cases and see if it could provide clear and understandable information for financial statements users.

Question 3
Do you agree with the analysis of the different characteristics of capital as the basis for distinguishing between equity and liabilities (pars. 1.14 ff.)? If not, why? Do you think that any other characteristics should be considered? If yes, which?

The different characteristics of capital which are developed in the table page 13 are relevant, the analysis of the equity/debt nature of these characteristics is correct and we have no other characteristics to add.

Question 4
Do you agree with the analysis in the paper on whether to base a capital distinction on one or more than one criterion (pars. 1.33 ff.)?

We do not agree with the analysis that a single criterion to define capital (or a cumulative set of criteria) is the most appropriate solution. Indeed, as mentioned previously, there are different characteristics of capital and it seems not appropriate to us that a financial instrument which would have almost all the characteristics of equity would finally be accounted for as debt because a single criterion is not met. To restrict capital distinction to a single criterion would lead to have a very homogenous and restricted class of capital – equity – and a very heterogeneous one – debt - which would include all the financial instruments, as different as they can be, which do not fulfil the single chosen criterion. An approach based on multiple criteria would have better chances to give an accurate representation of reality and to qualify as equity instruments with equity characteristics and as debt instruments with debt characteristics.

Question 5

Do you agree with the analysis in this paper that, in order to classify capital, either an entity view or a proprietary view has to be applied (pars. 1.40 ff.)? If not, why not?

Do you agree with the paper's description of the implications of each approach (pars.2.35 ff., 3.22 ff.)? If not, why?

This analysis and its implications seem appropriate to us.

Question 6

Do you agree with the analysis of the needs of the users of financial statements in the context of classifying capital (pars. 3.1 ff.)?

We globally agree with the analysis of the need of the users of financial statements even if they are very general and not relevant for specific entities: for example, in a co-operative, members are generally far more concerned with the risk inherent to their investment than the return provided by it, as co-operative shares are risk absorbing but usually provide a limited return and are redeemable at book value. As a consequence, in a co-operative, the "investors", who are the co-operative members, do not have exactly the same needs than the investors in a publicly traded entity: very often, the services provided to them by the co-operative are far more important than any financial return they may receive on the equity provided.

Question 7

Do you agree that basing the distinction between equity and liabilities on risk capital would provide decision-useful information to a wide range of users of financial statements about entities in different legal forms (pars. 3.5 ff.)? If not, why?

Is there any other basis for the distinction that you would consider providing more useful information? If yes, which and why?

We do agree that basing the distinction between equity and liabilities on risk capital would provide decision-useful information to a wide range of users of financial statements about entities in different legal forms.

It would notably be the case for co-operatives, which member shares constitute risk capital and should as a consequence, in our view, be accounted for as equity.

Question 8

Do you agree with the analysis of losses as either economic losses or accounting losses in the context of classifying capital as equity or liabilities (pars. 4.1 ff.)? If not, why? Would you agree that the Loss Absorption Approach should focus on accounting losses?

We do agree with this analysis.

Question 9

Do you think that the Loss Absorption Approach is explained sufficiently clear in this paper (Section 4)?

Do you agree with the definition of loss-absorbing capital in par. 4.16? If not, why? How could this definition be improved?

The Loss Absorption Approach is explained sufficiently clear in this paper, some further explanations could be provided (with some concrete examples) on the way the circular element, which is the main limit of the loss absorption approach, could be dealt with.

We do agree with the definition of loss-absorbing capital in par. 4.16 (*Capital is deemed risk capital and, thus, presented as equity if it is available for loss absorption from an entity's perspective).*

Question 10
Do you agree that classification of an instrument as equity or liability should be based on the terms and conditions inherent in the instrument?
Do you agree that the passage of time should not be the trigger for reclassification of an instrument (pars. 4.22 ff)? If not, why?

We do agree that the classification of an instrument as equity or liability should be based on the terms and conditions inherent in the instrument and that the passage of time should not be the trigger for reclassification of an instrument.

Question 11
Do you agree with the discussion on linkage (pars. 4.31 ff.)?

We do agree with the view expressed in the discussion paper on linkage **-** that instruments issued at the same time should be considered together if they are part of the same arrangement between the transacting parties to avoid structuring opportunities.

Question 12
Do you agree with the discussion on split accounting (pars. 4.36 ff.)?

We do agree with the view expressed in the discussion paper on split accounting **-** that instruments with less than 100% loss absorption capability would be split in two parts, one of them being loss absorbing and to be presented as equity and the other as debt.

Question 13
Do you agree with the discussion of the different approaches to distinguish equity from liabilities within a group context in general and with regard to the Loss Absorption Approach in particular (section 5)? If not, why?
Would you prefer the approach set out in par 5.1(a) or the approach in par. 5.1 (b)? Why?

We do agree with the discussion of the different approaches to distinguish equity from liabilities within a group context.

The approach set out in paragraph 5.1(a) (to retain at the group level the classification made at the level of each entity) seems easier to apply but needs to be developed to prevent structuring opportunities and inconsistencies. To reassess the classification of each instrument at the group level (5.1(b)) would be too complex a method.

Question 14
Do the examples in section 6 illustrate the loss-absorption principle well? Would you have reached a different conclusion (or classification)? Why? Are there any other aspects of the Loss Absorption Approach that need to be illustrated?

The examples in section 6 illustrate the loss-absorption principle well and so does in particular the example of co-operative member shares on page 87.

<u>Questions on the loss absorption approach in general</u>

Question 15
Do you believe that the Loss Absorption Approach is sufficiently robust to be prescribed in an accounting standard? If not, why? If you are concerned about structuring opportunities what would be your suggestion to limit the structuring opportunities?

We do believe that the Loss Absorption Approach is simple and economically sound: it is an alternative approach to the ones presented by FASB and should be considered seriously by the international accounting standard setters, as we mentioned it in our comment letter to the FASB preliminary views document. It seems essential to us, for this approach to be supported by international accounting standard setters, that the unsolved questions raised in this discussion paper (circularity, application within a group context) are further developed.

Question 16
Do you think the Loss Absorption Approach should be simplified? If yes, how could the Loss Absorption Approach be simplified?

In our opinion, the loss absorption approach doesn't need to be simplified, as it is simple enough.

Question 17
This Discussion Paper is based on the view that the current IFRS approach to distinguish equity from liabilities has shortcomings.
Do you agree with the analysis of the current IFRS approach to distinguish equity from liabilities (section 2)? Do you agree that the current approach has shortcomings as identified in this paper (pars. 2.17 ff.)? If not, why? Do you see any other shortcomings?
Do you see advantages of the current approach?

We do agree with the analysis of the current IFRS approach to distinguish between equity and liabilities and that this approach has shortcomings

Under the current IFRS approach, co-operative member shares are accounted for as equity as long as the co-operative has an unconditional right to refuse their redemption.

The international co-operative community rallied and made significant compromises to comply with this approach. Indeed, for many co-operatives, it forced some changes in their national or regional laws, bylaws and structure of their organization.

This approach has been in place and working for many cooperative financial institutions for more than 2 years. It accommodates the cooperative business model in many countries, though it does not everywhere as some national laws state that co-operatives have an obligation to redeem their member shares at the option of the holders.

Question 18
Do you believe that the Loss Absorption Approach would represent an improvement in financial reporting over the current IFRS approach? Do you think that the distinction based on this approach provides decision-useful information? If not, why?
Do you have any other comments?

For co-operatives, the loss absorption approach would certainly represent an improvement in financial reporting over the current IFRS approach, as all co-operative member shares, which are loss absorbing capital, would be accounted for as equity under the loss absorption approach, which is not always the case under the current IFRS approach.

Furthermore, the distinction based on this approach between loss-absorbing capital and debt provides decision-useful information, particularly for investors and lenders who can get a clearer view on the true level of risk capital of the entity.