Co-operatives UK
THE UNION OF CO-OPERATIVE ENTERPRISES

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Dear Sir,

RE: Discussion paper: Distinguishing between Liabilities and Equity

Attached is the response of the Performance & Accounting Standards Committee (PASC) of Co-operatives^UK in relation to the Discussion Paper.

PASC is a standing committee of Co-operatives^UK, which brings together professionals from within the co-operative movement to take responsibility for the movement's performance indicators and for promoting best practice on accounting standards.

PASC welcomes the publication of this discussion paper looking at distinguishing between liabilities and equity. In particular it welcomes the consideration of entities that are not joint stock companies. In general we are supportive of the ideas behind this, particularly the identification of risk capital and the loss absorption approach to define equity and we see this as particularly relevant for Co-operatives and mutual entities. We believe that future accounting standards based on this theoretical underpinning would be a useful addition to the overall body of standards.

Co-operatives^UK is a co-operative owned and democratically controlled by its members. It was launched in January 2003 following the merger of the Co-operative Union (established in 1869) and the Industrial and Common Ownership Movement (ICOM). Co-operatives^UK can therefore claim to have been in the business of promoting and representing co-operative enterprise for over 139 years. Co-operatives^UK membership comprises individual co-operative enterprises ranging in size and diversity from large consumer owned co-operatives to small worker owned co-operatives. The number of co-operative organisations in membership exceeds 450 and has a combined turnover in excess of £13 billion. It employs over 98,000 staff trading through 4,500 retail outlets.

Yours sincerely

Phil Holmes FCCA
Secretary - PASC
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?
While there is a need for a clear balance sheet structure, defining more than two different classes of capital would lead to more complexity for the end users. However, most users will understand the basic concept of the two-part classification.

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?
Yes. In terms of transparency it clearly describes the financial obligations of the various instruments and claims on the entity.

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?
Yes.

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.)?
Yes, although we believe that, on the assumption that a cumulative definition is used, it is sensible to rely on as few criteria as possible.

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?
We agree that in order to classify capital it is fundamental to have perspective as to the underlying view of the accounts, i.e. whether they are prepared under an entity or proprietary view, otherwise there is likely to be inconsistent treatment of equity/liabilities as demonstrated in the paper by its analysis of current IFRS.

However while we accept the theoretical analysis and distinction we suspect that in practice it may be difficult to produce a set of standards based wholly on one view or the other that are totally consistent. For example if an entity view is taken this on its own might not give decision useful information to proprietors and to capital markets who view the entity from the perspective of the proprietors. Similarly a proprietor approach may not give to decision useful information to a mutual entity where the entity approach reflects the commonality of approach between the entity and its members.

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

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.)?
Yes

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?
We agree that basing a distinction between equity and liabilities on risk capital provides decision-useful information to a wide range of users of financial statements. In particular basing the distinction on risk capital gives decision useful information across different types of entity and a degree of comparability across different types of entity. In particular basing a distinction on risk capital allows non joint stock companies to appropriately recognise equity and liabilities. Clearly the level of risk capital, and its description consistently as equity, would provide useful information both to the providers of risk capital themselves and to other providers of finance.

Is there any other basis for the distinction that you would consider providing more useful information? If yes, which and why?
No

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?

Yes. The idea of defining losses as economic losses does have practical impediments and is of a theoretical economic nature. We feel that the LAA focus on accounting losses is not unnecessarily complex.

Question 9
Do you think that the Loss Absorption Approach is explained sufficiently clear in this paper (Section 4)?
Yes. However, the justification and underlying rationale is complex and if this could be simplified it would be helpful. Indeed, it would need to be simplified for any future accounting standard.

Do you agree with the definition of loss-absorbing capital in par. 4.16? If not, why?
Yes

How could this definition be improved?
Quite a general definition that doesn't deal with all claims as loss absorbing, as described in 4.17 & 4.18. Possibly you may wish to incorporate the most sub-ordinated class of capital within the definition.

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? **Yes**

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 agree that the passage of time should not be the trigger for reclassification. However, if it is ultimately decided that the passage of time should be the trigger for reclassification of an instrument, then there should be adequate disclosure of the terms in order that users are not misled.

Question 11
Do you agree with the discussion on linkage (pars. 4.13 ff.)?
Yes, as an anti-avoidance measure but we agree that further work is necessary.

Question 12
Do you agree with the discussion on split accounting (pars. 4.36 ff.)?
Yes, it would appear to make sense to allocate only that part of the financial instrument that is capable of absorbing losses as equity, with the balance as a liability.

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?
Yes

Would you prefer the approach set out in par 5.1(a) or the approach in par. 5.1 (b)? Why?
Approach (b) Re-assess at group level. This is what we would consider to be the normal approach.

Question 14
Do the examples in section 6 illustrate the loss-absorption principle well? Would you have reached a different conclusion (or classification)? Why?
Probably the best part of the discussion paper. The examples all appear to be appropriate and easy to follow.

Are there any other aspects of the Loss Absorption Approach that need to be illustrated?
No.

Questions on the loss absorption approach in general
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?
Yes. However, in guidance terms, the rules of linkage in particular and split accounting could be developed further to restrict structuring opportunities.

Question 16
Do you think the Loss Absorption Approach should be simplified? If yes, how could the Loss Absorption Approach be simplified?
See response to question 9
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)?
Yes.

Do you agree that the current approach has shortcomings as identified in this paper (pars. 2.17 ff.)? If not, why?

Yes, in particular we agreed that currently equity is only defined as a residual after identifying liabilities and that there is a confusion of view between the proprietary and entity view.

Do you see any other shortcomings?
Additionally to the above we see the level of complexity in the current approach as a shortcoming. An excessive level of complexity can make accounts less useful.

Do you see advantages of the current approach?
The key advantage is that the current approach is a systematic attempt to describe liabilities and to treat them consistently.

Question 18
Do you believe that the Loss Absorption Approach would represent an improvement in financial reporting over the current IFRS approach?
Yes.

Do you think that the distinction based on this approach provides decision-useful information? If not, why?
Yes, it does provide decision-useful information, particularly for entities that are not joint stock companies.