CL 137G

Co-operative Union Ltd

incorporating ICOM - the worker co-op federation

Mr. Paul Ebling
Project Director
Accounting Standards Board
Holborn
100 Grays's Inn Road
London

Holyoake House
Hanover Street
Manchester M60 0AS

T 0161 246 2900
F 0161 831 7684

25th October 2002

Dear Mr. Ebling

Fred 30: Financial Instruments

We write to you in support of the attached response of the Co-operative Accounting Standards Committee (CASC) to your consultation on FRED 30.

The Co-operative Union is the representative body for the UK co-operative movement and in particular the consumer co-operative sector. The combined annual turnover of consumer co-operatives in this country is nearly £11 billion. It employs 114,000 staff trading through 4,800 retail outlets; farms 85,000 acres and owns the Co-operative Bank and the Co-operative Insurance Society.

The CASC is a standing committee of the Co-operative Union and responds to all ASB consultations and advises UK co-operatives on accounting practice and procedures.

We write to reinforce the strength of concern within the co-operative sector at the potential implications for our businesses of FRED 30. Co-operative withdrawable share capital is a unique financial instrument. We are concerned that its specific attributes and the distinct business structure of co-operatives have not been fully taken into account in the formulation of FRED 30. Applying principles applicable to the public company sector to co-operatives is right and proper in many areas of accounting procedure.

With regard to the treatment of our share capital, however, it is inappropriate and could be very damaging. HM Treasury has recognised the unique characteristics of co-operative withdrawable share capital and we urge the ASB to look carefully at the arguments made in the attached paper that lays out the key elements which differentiate our financial structure from that of a plc.

The attached paper from the Chairman of our Accounting Standards Committee requests a meeting to enable a small delegation to explain our argument and answer any questions the ASB may have. We very much hope that you will look sympathetically on that request.

Yours sincerely,

Pauline Green
Chief Executive &
General Secretary

Bob Burlton
Chairman

Enc.

Co-operative Union Ltd

25 October 2002

Mr P Ebling
Project Director
Accounting Standards Board
Holborn
100 Gray's Inn Road
London
WC1X 8AL

Holyoake House
Hanover Street
Manchester M60 0AS

T 0161 246 2900
F 0161 831 7684

Dear Mr Ebling

Re.: FRED 30: Financial Instruments

Firstly, I would like to thank you for agreeing to extend the deadline for receipt of submissions in respect of FRED 30.

Background

I am responding to FRED 30 on behalf of the Co-operative Accounting Standards Committee, which considers new accounting developments (including Financial Reporting Exposure Drafts) on behalf of the Co-operative Movement. The Committee is comprised principally of senior accountants from the major cooperative societies in the UK. Co-operative societies are governed by Industrial and Provident legislation and are supervised by a specialist unit within the FSA. The financial statements of Industrial and Provident societies are prepared in accordance with UK GAAP.

Co-operatives are membership-based businesses that exist to serve the needs of their members who collectively own the business. One of the primary objectives of consumer cooperatives is to trade for the benefit of theft members. Essentially, this means that the members who transact with the Society will benefit from its profits. Unlike the company sector, co-operatives do not exist to generate returns for investor shareholders.

However, co-operatives do require funds and individuals can become members of a co-operative by purchasing a minimum of one share for £1 (all shares have a fixed value of £1) which entitles each member to one vote. Currently, members may invest a maximum of £20,000, although a member has only one vote irrespective of the value of the share capital held. Co-operative share capital is withdrawable on demand by members..

Overview

This response is in respect of the proposals contained within FRED 30 which relate to the changes to the categorisation of shareholders' funds only. Under FRED 30, the categories for capital instruments will change from 'liabilities' and 'shareholders' funds' to 'liabilities' and 'equity'.

The current proposals set out in FRED 30 require certain financial instruments, which are currently treated as equity, to be treated as debt, for example preference shares. This is of considerable concern to the Cooperative Movement and would essentially mean that cooperative share capital would be classified as debt. Co-operative share capital does share many, but not all, of the features of equity share capital in the company sector, but similarly it does not meet all the features of debt. Further, and crucially, this step would be diametrically opposed to HM Treasury policy in recent years, whereby in high-level discussions with the Co-operative Movement during 1998-2000 on the legal basis of co-operative share capital, HM Treasury ruled that it was risk capital.

In summary, we strongly recommend to the ASB that a third category of financial instruments is included within the new Financial Reporting Standard on Financial Instruments, which recognises the existence of financial instruments that are technically neither equity nor debt.

Email: pgreen.coopunion@co-op.co.uk

This letter summarises the key points which support the case for a third category of financial instruments that would address the hybrid nature of financial instruments like co-operative share capital, and which are essential to the continuing operations and the development of co-operatives.

Current accounting treatment of members' share capital

Co-operative share capital is currently reported as non-equity share capital, in accordance with guidelines established by FRS4. This treatment was mainly adopted for co-operative share capit4, because these shares were considered to be akin to preference shares.

Key arguments for treating Co-operative share capital as *equity*

- *Member rights*

  The shareholding members of co-operatives are the owners of those business and have the right to determine how they operate.

- *Risk capital*

  The legal basis for co-operative share capital is approved by HM Treasury and the rules of co-operatives are subject to approval by the Mutual Societies Registration Office within the FSA. This share capital is subject to a voluntary Code of Practice that was agreed and came into effect in 2001, following extensive discussions between representatives of the Co-operative Movement and HM Treasury. The Code makes it clear to the investor that this share capital is 'risk capital' and, therefore, is subject to the same 'pecking order' as shareholders of a company, in the event of the Society being wound-up. This feature of co-operative share capital is a key similarity to share capital in the company sector.

  There is now no provision for co-operatives to make use of loan deposits from the public as a form of funding.

  There would be inconsistencies in classifying co-operative share capital as loan deposits (as required by FRED 30), when the guidelines that were agreed with HM Treasury make no provision for cooperatives to accept loan capital.

- *Withdrawable share capital*

  Whilst co-operative share capital is withdrawable, the Boards of Co-operative Societies can suspend the repayment of share capital as and when they consider appropriate. This could happen, for example, if societies were to face liquidity problems.

- *Distributions*

  Although Co-operative members receive interest on their share capital (usually at modest rates), their main return is to share in distributions of profits based on their purchases with their Society. This basis varies between societies and is normally linked to the profitability of the Society for each financial year. This differs substantially from conventional debt, where the returns are fixed.

- *Entitlement to reserves*

  Most societies contain a non-distribution clause in their Rule Book, which prevents members from sharing in the reserves of the Society in the event of a winding-up. If a Society is wound up, the reserves are to be used for the furtherance of the Cooperative Movement. This clause was introduced to protect societies against 'Carpetbaggers'.

  However, this is a voluntary clause and can potentially be changed by members to make assets available to them for distribution to them.

- *Current liabilities*

  The current drafting of FRED 30 would suggest that if co-operative share capital is treated as debt, it would be shown as a current liability as this share capital can be withdrawn with little notice (if any).

  This would be inappropriate because much of co-operative share capital is held by members for the long term, in support of their co-operative.

Summary

As highlighted above, we consider that there are some compelling reasons for introducing a third type of financial instrument to recognise that hybrid forms of financial instruments exist, which are neither debt nor equity. However, I would be pleased to provide any further information that you may consider to be appropriate.

In view of the significance of this exposure draft and its potentially adverse impact on co-operatives, we would welcome a meeting with you to explain in more detail the 'Co-operative Difference' and to discuss this crucial matter of the proper classification of co-operative share capital further. I will call you next week, to ascertain whether you are agreeable to a meeting and, if so, to arrange a mutually convenient date and time.

I look forward to meeting you in due course.

Yours sincerely

C G Wallis FCA
Chair of Co-operative Accounting Standards Committee