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July 28, 2008

**Via E-mail**

Paul Ebling, Technical Director – EFRAG  
European Financial Reporting  
Advisory Group  
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1210 Brussels  
Belgium  
Via email to: [Commentletter@efrag.org](mailto:Commentletter@efrag.org)

Re: Comments on FASB Preliminary Views document – “Financial Instruments with Characteristics of Equity” in conjunction with the discussion paper issued by the European Financial Reporting Advisory Group (“EFRAG”) entitled “Distinguishing Between Liabilities and Equity”

Unified Grocers, Inc. (“Unified” or “the Company”) is writing in regards to your discussion paper “*Distinguishing Between Liabilities and Equity*” (the “discussion paper”) and its potential impacts on cooperative businesses.

We support the initiative you have undertaken to address an area that has particular importance and potential impact to the cooperative business community. We note that the Financial Accounting Standards Board (“FASB”) has mentioned the EFRAG “loss absorption approach” in its Preliminary Views document – “*Financial Instruments with Characteristics of Equity*” (the “Preliminary Views”) that will serve as a first step toward a joint project with the International Accounting Standards Board (“IASB”) on the topic.

We believe that accounting standards need to be both simple and clear. We therefore support the movement toward a more principles-based approach if that would result in standards that offer improved simplicity and clarity in their interpretation and application.

We support the principal elements of the “loss absorption approach” and believe it has potential appeal to cooperatives because cooperative member shares would be classified as equity regardless of other considerations (including, but not limited to, redemption conditions, claims on net assets at liquidation, etc). We believe the “loss absorption approach” holds promise for cooperatives and all businesses that operate with “at risk” capital. It takes into consideration both the interests of publicly traded companies and the business and financial results of companies, particularly cooperatives, whose equity securities are issued and redeemed at book value (“book value companies”). This approach provides a broad range of financial

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statement users with decision-useful information concerning entities in different legal forms across different jurisdictions.

Unified believes that the “loss absorption approach” discussed by EFRAG in conjunction with certain modifications to the FASB’s basic ownership approach would provide improved clarification and simplicity in determining how ownership instruments are classified. 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.

Unified generally supports and agrees with the position stated by the FASB in its Preliminary Views that the basic ownership approach is the appropriate method for determining which instruments should be classified as equity instruments, particularly with respect to the underlying concept that the most residual claim on net assets is classified as equity. We do, however, disagree with one of the FASB’s proposed requirements in the Preliminary Views that basic ownership instruments have “*no upper* or lower *limit* except for the amount of assets available” (emphasis added) and have proposed modifications in our response to the FASB’s invitation to comment (included herein as an attachment to this letter) that we believe necessary to improve its simplicity and clarity. We believe this modification is supported by assertions in section 3.14 of your discussion paper wherein you state that “*it is the loss participation element*” (as opposed to “*participation in losses and profits*” as discussed in section 3.11) “*that distinguishes risk capital from any other form of financing instrument and, therefore, best provides a user of financial statements with decision-useful information about an entity’s types of capital.*” We share in your conclusion that “*participation in losses is the decisive factor in distinguishing risk capital from all other types of capital*” and have encouraged the FASB to add this important element to their criteria to be used in determining the classification of ownership instruments.

We believe the basic ownership approach could be further enhanced and simplified by incorporating elements of promulgated and proposed international literature that would further the goal of moving toward convergence with international standards while also addressing the concerns of book value cooperative organizations. These include: (1) incorporating components of the “loss absorption approach” as presented in your discussion paper and referenced by the FASB in Appendix E of its Preliminary Views, and (2) adopting an approach consistent with that of International Financial Reporting Interpretations Committee (“IFRIC”) Interpretation No. 2 (“IFRIC 2”), “*Members’ Shares in Co-operative Entities and Similar Instruments.*”

In determining classification of equity instruments, Unified favors the improved simplicity and clarity offered by convergence with approaches either adopted or considered by the FASB or international accounting literature, specifically:

- Under IFRIC 2, “*Members’ Shares in Co-operative Entities and Similar Instruments,*” the IFRIC reached consensus that “*Members’ shares are equity if the entity has an unconditional right to refuse redemption of the members’ shares,*” and

- Incorporate components of the loss absorption approach presented in your discussion paper and referenced by the FASB in Appendix E to its Preliminary Views. We refer specifically to your assertions that (1) “*loss-absorbing capital serves as a buffer or cushion in protecting the claimants of non-risk capital,*” (2) “*participation in losses is the decisive factor in distinguishing risk capital from all other types of capital*” and (3) equity is equated to risk capital or “*buffer capital.*”

As presented in the attached response letter to the FASB, Unified requested the FASB to address certain issues during its deliberations of comments received on the Preliminary Views document. In addition, we respectfully request that EFRAG give consideration during its deliberations to incorporating elements of the FASB’s basic ownership approach, including addressing the following concerns as presented to the FASB:

- Eliminate the requirement that basic ownership instruments have “*no upper limit except for the amount of assets available.*”
- Adopt an approach consistent with that of IFRIC 2 with respect to cooperative entities, whereby “*Members’ shares are equity if the entity has an unconditional right to refuse redemption of the members’ shares.*” Since IFRIC 2 has already been accepted in the international standard-setting community, we believe that adoption of this approach would further the goal of moving toward convergence with international standards while also addressing the concerns of book value cooperative organizations.
- Incorporate components of the loss-absorption approach in the forthcoming FASB Exposure Draft as part of the criteria used in determining classification under the basic ownership approach. We refer specifically to the assertions that “*loss-absorbing capital serves as a buffer or cushion in protecting the claimants of non-risk capital,*” and “*participation in losses is the decisive factor in distinguishing risk capital from all other types of capital.*” Further, we believe this approach should be considered by the FASB because it allows for more forms of equity interest, meets the goal of decision useful information for investors, and can meet the needs of all forms of corporate structure while advancing the FASB goal of simplifying the complexity associated with classifying equity instruments.
- Modify certain classification criteria as presented in the Preliminary Views to provide for its application to equity instruments regardless of whether or not they are considered mandatorily redeemable. This would add simplicity and clarity to the criteria used in evaluating an instrument’s classification as a basic ownership instrument under the basic ownership approach.

European Financial Reporting Advisory Group

Re: *"Distinguishing Between Liabilities and Equity"*

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If you have any questions concerning any aspect of the foregoing, please do not hesitate to contact me directly at (323) 264-5200 (ext. 4281).

Very truly yours,

A handwritten signature in black ink that reads "Richard J. Martin". The signature is written in a cursive, flowing style.

Richard J. Martin,  
Executive Vice President,  
Finance & Administration,  
and Chief Financial Officer

**Enclosures:**

Unified Grocers, Inc. letter of response to the FASB – File Reference No. 1550-100 – Comments on FASB Preliminary Views document – “Financial Instruments with Characteristics of Equity”



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May 30, 2008

**Via E-mail**

Technical Director – File Reference No. 1550-100  
Financial Accounting Standards Board  
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Re: File Reference No. 1550-100 – Comments on FASB Preliminary Views document  
– “Financial Instruments with Characteristics of Equity”

Unified Grocers, Inc. (“Unified” or “the Company”) is responding to your request for comments on a number of matters outlined in your Preliminary Views document “*Financial Instruments with Characteristics of Equity*” (the “Preliminary Views”). We note that your plan is to utilize the Preliminary Views document as a first step toward a joint project with the International Accounting Standards Board (“IASB”) on the topic.

We support the FASB’s stated objective to move toward a more principles-based framework relative to standard setting, wherein such an approach would emphasize adherence to accounting principles and concepts to facilitate the broader goal of achieving international consistency in the establishment of accounting and reporting standards. Under a principles-based approach, it is our understanding that the philosophy reflecting the fundamental recognition, measurement, and reporting requirements of accounting standards would (1) continue to be developed using the conceptual framework, (2) “*apply more broadly than under existing standards, thereby providing few, if any, exceptions to the principles*” and (3) there would be less interpretive and implementation guidance for applying the standards. That, in turn, would “*increase the need to apply professional judgment consistent with the intent and spirit of the standards.*” We believe that accounting standards need to be both simple and clear. We therefore support the movement toward a more principles-based approach if that would result in standards that offer improved simplicity and clarity in their interpretation and application.

Unified generally supports and agrees with the FASB’s position stated in the Preliminary Views that the basic ownership approach is the appropriate method for determining which instruments should be classified as equity instruments, particularly with respect to the underlying concept that the most residual claim on net assets is classified as equity. We also support selection of the basic ownership approach over the ownership-settlement and reassessed expected outcomes approaches because it strives to more closely identify the “lowest common denominator” of equity and should prove easier to apply than the other two approaches. By

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implication, a broadly applied concept such as basic ownership interest should reduce opportunities afforded under more rules-based approaches to “*structure instruments and arrangements to achieve a desired accounting treatment.*” We do, however, disagree with the proposed requirement in paragraph 18 (b) that basic ownership instruments have “**no upper** or lower **limit** except for the amount of assets available” (emphasis added) and will propose modifications that we believe necessary to improve its simplicity and clarity. We believe the basic ownership approach could be further enhanced and simplified by incorporating elements of promulgated and proposed international literature that would further the goal of moving toward convergence with international standards while also addressing the concerns of book value cooperative organizations. These include: (1) an approach consistent with that of International Financial Reporting Interpretations Committee (“IFRIC”) Interpretation No. 2 (“IFRIC 2”), “*Members’ Shares in Co-operative Entities and Similar Instruments,*” and (2) components of the loss absorption approach discussed by both the FASB in Appendix E to the Preliminary Views and the Pro-Active Accounting Activities in Europe (“PAAinE”). Finally, we will propose modifications to paragraph 21 providing for its application to equity instruments regardless of whether or not they are considered mandatorily redeemable.

We respectfully request that the FASB give further consideration to the impact on the business and financial results of companies, particularly cooperatives, whose equity securities are issued and redeemed at book value (“book value companies”) prior to developing an Exposure Draft of a proposed Statement of Financial Accounting Standards based on the Preliminary Views document.

### **Executive Summary**

As requested by the FASB under its “*Summary of Issues,*” Unified Grocers will provide comments regarding certain of the issues raised in the Preliminary Views document pertaining to cooperatives generally and our company in particular. Specifically, we will summarize accounting issues affecting Unified under the Preliminary Views as proposed and discuss modifications that will clarify and improve the document’s overall application to cooperative organizations as a whole.

In determining classification of equity instruments, Unified favors the improved simplicity and clarity offered by convergence with approaches either adopted or considered by the FASB or international accounting literature, specifically:

- Under IFRIC 2, “*Members’ Shares in Co-operative Entities and Similar Instruments,*” the IFRIC reached consensus that “*Members’ shares are equity if the entity has an unconditional right to refuse redemption of the members’ shares,*” and
- Incorporate components of the loss absorption approach discussed by both the FASB in Appendix E to the Preliminary Views and the PAAinE. We refer specifically to the assertions that “*loss-absorbing capital serves as a buffer or cushion in protecting the claimants of non-risk capital,*” and “*participation in losses is the decisive factor in distinguishing risk capital from all other types of capital*” and equity is equated to risk capital or “*buffer capital.*”

Our discussion also focuses on these additional issues:

- Independent grocers participate in cooperatives because of the benefits afforded them in operating their supermarkets. Members don't buy shares solely for their potential appreciation.
- Member shareholdings constitute a total "ownership package" and are characterized by two uniquely distinguishing features:
  1. Member shares may only be sold back to the issuing cooperative, and
  2. The Board of Directors has sole discretion to determine if repurchase will occur.

Until the decision is made to repurchase shares, and as long as shares participate equally in liquidation, they continue to represent "true equity" at its lowest common denominator. This leads to our major point – an upper limit on redemption should not change a share's classification as long as that share participates ratably in losses with other classes of shares in the event of liquidation.

The criteria in paragraph 18 (b) requiring a holder's share to have no upper limit on participation in the event net assets are liquidated or sold at a premium poses particular issues for certain types of direct ownership instruments (see "*Background*" and "*Discussion*" for additional detail). It also adds a criterion that we believe unnecessary to define a basic equity instrument.

With respect to ownership instruments that a company has no obligation to redeem (i.e., its board of directors has the right to deny any redemption request), the FASB's approach does not seem to place any constraints on the amount at which such instruments might ultimately be redeemed in the event its board chooses to permit redemption. In future deliberations leading to an Exposure Draft, we request the FASB to explicitly clarify that the amount at which redemption of ownership instruments occurs does not impact the liability versus equity analysis as long as a company is under no obligation to redeem such instruments. In conjunction with this view, from a broader perspective, we believe the basic ownership approach would be improved by a modification to paragraph 21 such that it would apply to ownership instruments whether or not they are considered mandatorily redeemable. This would add simplicity and clarity to the criteria used in evaluating an instrument's classification as a basic ownership instrument (see "*Discussion*" for additional detail).

## **Background**

Unified Grocers, Inc. is a retailer-owned, grocery wholesale cooperative serving supermarket, specialty and convenience store operators located primarily in the western United States and the South Pacific. Unified's customers include its owners ("Members") and non-owners ("non-members"). Unified's Members are primarily independent grocers that range in size from single store operators to regional supermarket chains. To be able to receive the

benefits of membership in the cooperative, each Member is required to hold a specified number of Class A and B Shares of the Company's common stock.

***All purchases and sales of stock are based on Exchange Value Per Share and are not driven by outside market forces.***

Each Class A and B Share held by a Member has an issuance value equal to the Exchange Value Per Share ("Exchange Value") of the Company's outstanding shares at the close of the last fiscal year end prior to the issuance of such shares.

Exchange Value is computed based on the sum of the fiscal year end balances of Class A and Class B Shares, plus retained earnings, divided by the number of Class A and Class B Shares outstanding at the end of the fiscal year. Exchange Value Per Share does not necessarily reflect the amount the net assets of the Company could be sold for or the dollar amount that would be required to replace them. Organizations similar to Unified whose equity securities are issued and redeemed at book value may be immediately impacted by adjustments affecting shareholders' equity upon implementation of new accounting pronouncements. Therefore, such pronouncements may require companies to redefine the method used to value their shares. As such, Unified modified its Exchange Value calculation to exclude accumulated other comprehensive earnings (loss), to eliminate the potentially volatile impact that adoption of new pronouncements may have on shareholders' equity and Exchange Value.

Unified's capital stock can only be held by Members, cannot be transferred without the consent of Unified's Board of Directors ("Unified's Board") and is subject to redemption as specified in the Articles of Incorporation and Bylaws. All redemptions occur solely at the discretion of Unified's Board, which has the right to amend the Company's redemption policy at any time. That is, Unified's capital stock is not mandatorily redeemable or redeemable at the option of the holder. Accordingly, ***Unified's capital stock, like that of other cooperatives, cannot be publicly traded and has limited liquidity.***

Unified's capital structure is comprised of the following major classes of shares representing Members' basic ownership interest in the cooperative.

**Class A Shares.** Each Member must own a number of Class A Shares as established by Unified's Board and specified in the Articles of Incorporation, and such shares may be held only by Members of Unified.

**Class B Shares.** Unified requires each Member to hold Class B Shares having an issuance value as established by Unified's Board and specified in the Articles of Incorporation.

Purchases and sales of Class A and Class B Shares are primarily driven by membership requirements and based on Exchange Value Per Share rather than outside market forces.

**Class E Shares.** In order to enhance equity capital, Unified's Board periodically provides for Class E Shares to be issued as a portion of the patronage dividends issued by the Company, as determined annually at the discretion of Unified's Board (earnings of the

Company's three patronage earning divisions are distributed to Members in the form of patronage dividends). Class E Shares have a stated value of \$100 per share. Pursuant to the Company's redemption policy, Class E Shares cannot be repurchased for ten years from their date of issuance unless approved by Unified's Board or upon sale or liquidation of the Company. The shares, when redeemed, will be redeemed at stated value. Class E Shares participate ratably in liquidation, dissolution or winding up of the corporation, subject only to the not-to-exceed amount of \$100 per share. The holders of Class E Shares, however, are required to put their investment at risk because if there were a liquidation of the Company at net asset amounts lower than the stated value of their shares, they would participate ratably in the reduced amounts with the holders of Class A and Class B Shares. This distinction clearly differentiates such shares from debt, which would take priority over the holders of Class A and Class B Shares.

**Redemption of Capital Shares.** The Articles of Incorporation and Bylaws currently provide that Unified has the right to repurchase any Class A Shares, Class B Shares or Class E Shares held by a former Member, and any Class B Shares in excess of the Class B Share requirement held by a current Member, whether or not the shares have been tendered for repurchase. The repurchase of any Class A Shares, Class B Shares or Class E Shares is solely at the discretion of Unified's Board.

## **Discussion**

As requested by the FASB under its "*Summary of Issues*," the Company will provide comments regarding questions on the basic ownership approach, presentation and classification issues, technical perspectives and a brief discussion of the ownership-settlement approach and reassessed expected outcomes approach.

### **Basic Ownership Approach**

We support the FASB's proposal to utilize the basic ownership approach to determine equity classification of instruments as the clearest, most straightforward and least complicated of the options considered. We believe the basic ownership approach improves financial reporting because it simplifies classification of equity instruments (ownership) to the lowest common denominator of residual interest in a company. We concur with the criteria that "*a holder's share depends on its share of the total claims with the lowest priority.*" As discussed below, we believe this approach could be further enhanced and simplified by incorporating elements of promulgated and proposed international literature that would further the goal of moving toward international convergence while also addressing the concerns of book value cooperative organizations.

Unified's common shares of ownership in the cooperative are not mandatorily redeemable because Unified's Board retains the right to refuse redemption. Shares may be redeemed by the authority of Unified's Board but cannot be redeemed solely at the option of the holder. Therefore, paragraph 20 of the Preliminary Views would not be considered applicable to cooperative shares of ownership. As the FASB progresses toward convergence with the IASB, we also note that international literature supports this conclusion. Under International Financial Reporting Interpretations Committee Interpretation No. 2 ("IFRIC 2"), "*Members' Shares in Cooperative Entities and Similar Instruments*", the IFRIC reached consensus that "*Members'*

*shares are equity if the entity has an unconditional right to refuse redemption of the members' shares.*" Under our cooperative structure, our ownership instruments possess a unique element in that shares may only be sold back to the Company, and Unified's Board has sole discretion to decide if any repurchase is to occur. Until the decision is made to repurchase Members' shares, and the shares participate equally with current Members in the event of liquidation as discussed below, we believe the shares must continue to be classified as equity ownership instruments.

There are certain elements in the basic ownership approach as currently proposed that present challenges to companies, particularly cooperatives and other book value companies, whose equity securities are issued and redeemed at either a stated value or at book value. Specifically, Unified has the following concerns:

- Unified has different classes of stock that participate in changes in Exchange Value (Class A and Class B Shares) and a class of shares (Class E Shares with a stated value of \$100 per share) that does not likewise so participate. Under the current proposal in the Preliminary Views, a class of shares with a stated value would be considered a liability due to its upper limit upon liquidation. However, each class of stock is treated the same from the perspective that Unified's Board has the ultimate discretion to redeem them. There is no other way for the Members to obtain value for them since they cannot be sold to others or on the open market – to this end, all share classes would be at risk to absorb potential losses ratably if the Company's net assets were to decrease in value, subject only to the not-to-exceed amount of \$100 per share for Class E Shares. This would cause them to have the lowest priority in sharing the residual value in a distribution of net assets. We therefore believe that the upper limit criterion does not change the true equity nature of these shares.
- A further issue that arises in connection with an analysis of the upper limit criterion in the basic ownership approach is the treatment of Unified's Class B Shares pending redemption – How would the equity of former Members who have tendered their shares for redemption, but which have not yet been approved by Unified's Board, be treated?

We believe that as long as the equity held by former Members would be distributed in the same way at liquidation as that of current Members, it should continue to be classified as equity. However, read literally, the basic ownership approach could require these shares to be reclassified as liabilities. This is because one may assert that an upper limit has been placed on the amount of proceeds the holder of a share tendered for redemption can receive. Once the share has been tendered, Unified's Board can compel the holder to redeem the share at an amount equal to the last stated redemption value per share. This is an important point for any cooperative such as Unified that approves Members tendering shares for redemption at the last stated redemption value per share. We believe that these shares should continue to be classified as equity if they participate equally with current Members in the event of liquidation; therefore, the

upper limit criterion should likewise not change the equity nature of shares tendered but not yet approved by Unified's Board for redemption.

- With respect to ownership instruments that a company has no obligation to redeem (i.e., its board of directors has the right to deny any redemption request), the FASB's approach does not seem to place any constraints on the amount at which such instruments might ultimately be redeemed in the event its board chooses to permit redemption. Companies' boards typically have the unilateral prerogative to specify the redemption price of their shares based on the provisions of their bylaws or articles of incorporation and remain compatible with the spirit and intent of the methodologies discussed in paragraph 21. In future deliberations leading to an Exposure Draft, we request the FASB to explicitly clarify that the amount at which redemption occurs does not impact the liability versus equity analysis as long as a company is under no obligation to redeem such instruments.

In conjunction with this view, from a broader perspective, we believe the basic ownership approach would be improved by a modification to paragraph 21, which discusses criteria under which instruments redeemable at amounts approximating fair value – i.e., book value – would be classified as ownership instruments, such that it would apply to ownership instruments *whether or not they are considered mandatorily redeemable*. This would add simplicity and clarity to the criteria used in evaluating an instrument's classification as equity under the basic ownership approach.

Shareholder, Lender and Vendor Perspectives – Shareholders who are member-owners of a cooperative generally have different ownership interests in cooperatives than their counterparts who are equity owners in market value companies. Members purchase an equity interest in a purchasing cooperative because of the benefits afforded them in product pricing, vendor promotions, distribution, and a wide variety of services that benefit them in operating their supermarkets. Therefore, the primary goal of their equity participation is not a speculative investment made for the purpose of achieving a return on investment in the form of appreciated share price.

Cooperatives inherently tend to have lower equity than market value companies. This is typically integral to the design of the cooperative's capital structure, wherein the cooperative endeavors to facilitate the return of capital to owners, providing funds for the owners to expand their businesses. As the owners' businesses expand, their purchases through the cooperative will increase, enhancing the strength of the cooperative. Accordingly, defining basic ownership interests without modifying the criteria that requires no upper limit on redemption could result in Members' equity being reclassified as liabilities and have a greater percentage impact on the equity of cooperatives, as a group, than the impact on companies in similar industries who do not operate under the cooperative structure. Vendors who are selling goods and services to cooperatives and non-book value companies could conclude they must offer less advantageous pricing and terms to cooperatives. Lenders who base decisions on financial ratios and the establishment of loan covenants could place more onerous restrictions on book value companies as compared to market value companies as a result of any perceived loss of equity.

Both conclusions would miss the point that the capital supplied by shareholders owning Class E Shares is available to support the claims of the vendor and lender.

Additionally, an unnecessary element of uncertainty may be introduced for prospective shareholders considering cooperative membership should basic ownership elements traditionally reflected as equity be alternatively considered a liability and not a return of member capital.

*Incorporate elements of Loss Absorption Approach criteria into the Basic Ownership Approach* – The concept of a loss absorption approach has been given initial consideration by the FASB in Appendix E to the Preliminary Views. This approach “*classifies instruments or components of instruments as equity if the instrument’s claim on net assets is reduced if the entity incurs a loss.*” In contrast, “*if the claim represented by a debt instrument does not change due to an entity’s losses, it is classified as a liability.*” Under this concept, although the issuer may incur losses, the legal amount of the claim is unaffected.

In conjunction with our review of the basic ownership approach, we have also considered certain concepts raised by the Pro-Active Accounting Activities in Europe (“PAAinE”) group in their discussion paper entitled, “*Distinguishing Between Liabilities and Equity.*” Although not considered in the Preliminary Views, certain concepts presented in this paper appear to address our proposed modification to the basic ownership criteria, that is, requiring no lower limit in loss participation but removing the requirement for upper limit appreciation participation.

In Section 3 of the PAAinE discussion paper, a statement was made that risk capital “*absorbs losses incurred because the claim to the capital provided is automatically reduced.*” Therefore, “*loss-absorbing capital serves as a buffer or cushion in protecting the claimants of non-risk capital,*” and it is the “*buffer function of risk capital that provides decision-useful information for both investors and creditors across different legal forms.*” The PAAinE further concluded, “*participation in losses is the decisive factor in distinguishing risk capital from all other types of capital.*”

Section 4 of the PAAinE discussion paper asserts that “*Capital that is loss-absorbing from an entity’s perspective is presented as equity. **Since the entity cannot default on a loss-absorbing claim, loss-absorbing claims provide a buffer for the entity.***”

### **Presentation and Classification Issues**

*Statement of financial position* – The Preliminary Views document states “*basic ownership instruments with redemption requirements would be reported separately from perpetual basic ownership instruments.*” We did not interpret this requirement in the Preliminary Views to be applicable to shares that a company has chosen to redeem when it otherwise had no obligation to do so. We would, however, appreciate the Board’s clarification of this point during future deliberations. The purpose of the separate display is to provide users with information about the liquidity requirements of the reporting entity. Notwithstanding our interpretation above, Unified respectfully asserts that shares tendered and approved for redemption would only constitute a liability (to be reclassified from equity) to the extent the

shares are approved and for some reason not subsequently redeemed at the end of the reporting period. As long as the shares are approved for redemption and then subsequently redeemed within that reporting period, they would have properly been classified as equity. The Company already provides disclosures in the footnotes and Management's Discussion and Analysis of the liquidity requirements necessitated by such pending redemptions and discloses the financing sources utilized to facilitate such redemptions. In light of such disclosures, the Company does not believe that additional separate display requirements are necessary for the liability section of the statement of financial position in order to provide more information about an entity's potential cash requirements.

*Income statement* – The Preliminary Views document indicates that the FASB has not reached tentative conclusions about how to display the effects on net income that are related to changes in an instrument's fair value. Unified respectfully submits that shares of equity ownership in cooperatives and other book value companies are generally valued at book value or Exchange Value and would therefore not be subject to fair value "mark to market" adjustments. Accordingly, changes in equity resulting from the normal issuance and redemption of outstanding shares are disclosed as part of shareholder's equity and within the financing portion of the Statement of Cash Flows.

### **Technical Perspectives**

Unified respectfully requests that the FASB address certain technical issues relative to the Preliminary Views document that may have a greater impact on book value companies in general and cooperatives in particular. We are mindful that the Board has researched and thought about these issues in great detail; however, we would like to point out how the conclusions reached in the Preliminary Views would have a greater impact on book value companies than on publicly traded companies. Specifically, Unified has four primary concerns:

- First, Unified encourages the FASB Board to reconsider its requirement in paragraph 18 (b) that basic ownership instruments have "no **upper** or lower limit except for the amount of assets available (emphasis added)." We believe eliminating the "*no upper limit*" criteria on a holder's share of the total claims on net assets would further the Board's objective by providing an even more straightforward approach to basic ownership criteria and elevate the discussion to a clearer notion of what constitutes equity. According to our cooperative structure, upon liquidation, the assets of the Company would be distributed equally to all shares of Class A, B, and E without distinction based on class. However, amounts distributed to each share of Class E have an upper limit not to exceed \$100.00 per share, and any amount over such limit otherwise distributable to such shares would be reallocated among the shares of the other classes. Assuming the share liquidation value falls below \$100 per share (or any stated redemption value per share in principle) due to a reduction in net assets available for distribution, Members would participate equally upon liquidation and there would be no prioritization of class, resulting in all classes of shares continuing to be classified as equity. Therefore, the issue of lower limits upon liquidation does

not present a classification issue since all shareholders equally share in potential “downside risk.” Unified asserts that in the event the Company was to be sold at a premium and Class E shareholders were limited in participation to their stated value of \$100 per share, does that mere potential of an upper limit make a Member’s ownership interest a liability as opposed to being classified as equity in the Company? Introducing the notion of an “upper limit” on Members’ participation in a hypothetical net asset distribution based upon redemption value per share only complicates the classification issue and does not defeat the concept that these are equity owners of the company with interests subordinated to all other lenders and creditors. The determination of classification in our view should be keyed to the rights conveyed in the by-laws, articles, and other documents surrounding the instrument. If in liquidation they have no preferences and share equally in the distribution of residual net assets, then such instruments would be classified as equity.

The Company generally concurs that not all perpetual instruments should be classified as equity, because many perpetual instruments (such as preferred stocks) benefit from a priority in liquidation (discussed in paragraphs 65 and 66 in the *“Basis for the Board’s Preliminary Views - Why Would Other Perpetual Instruments and Derivatives on an Issuer’s Basic Ownership Instruments Not Be Classified as Equity?”*). However, perpetual instruments that do not have any priority in liquidation should be classified as equity, notwithstanding the upper limit criterion. Unified believes that removing the upper limit criterion for instruments that do not have any preference in liquidation would not in any way undermine the conceptual underpinnings of the basic ownership approach, and would not cause any of the additional complexities described in paragraphs 65 and 66.

We view the various ownership instruments held by member-owners in a cooperative form of business such as Unified’s to constitute a total “ownership package.” The Class E Share element of this ownership package has a different provision compared to Class A and B Shares as to participation in net asset appreciation, but in the event of liquidation where residual net assets have been reduced, all classes of shares participate equally, and as such, the total of all member shareholdings constitutes equity. Hence, to the extent that a particular class of shares has an upper (but no lower) limit in residual net asset participation, the fact that these shares are part of an ownership package is no less diminished; nor does this detract from the concept that member shareholders continue to own the lowest residual form of equity in the company. Unified strongly believes that the existence of upper limits on the redemption value per share does not defeat the concept that these are equity owners of the company with interests subordinated to all other lenders and creditors. Accordingly, an exception of upper limit criteria from the characteristics of basic ownership interests for cooperatives and other book value companies is strongly recommended.

- Secondly, we assert that due to Unified's Board's sole discretion to redeem them, our Class E Shares, in effect, operate in much the same manner as callable common shares at a fixed price. Under current GAAP, such shares are considered equity and would represent a basic ownership instrument under the basic ownership approach or a perpetual instrument under the ownership-settlement approach, and would subsequently be measured at their current redemption value. Furthermore, holders of Class E Shares have no priority claim to the Company's net assets, except upon liquidation, whereby they have the same claim to residual net assets as the holders of the Company's other share classes, subject only to the not-to-exceed amount of \$100 per share.
- Third, Unified believes that its Members' investment constitutes risk capital that is loss-absorbing. Section 4 of the PAAinE discussion paper asserts that "*Capital that is loss-absorbing from an entity's perspective is presented as equity. Since the entity cannot default on a loss-absorbing claim, loss-absorbing claims serve as a buffer or cushion in protecting the claimants of non-risk capital.*" We concur with the PAAinE's conclusion that "*participation in losses is the decisive factor in distinguishing risk capital from all other types of capital.*"

These elements of the loss-absorption approach would appear to provide a basis to help the FASB further simplify the basic ownership approach and reduce the question of an instrument's classification to one central issue – **if the holder of the instrument can suffer a loss with no recourse, then it truly constitutes equity**. The added criterion of an "upper limit" on participation in net asset distribution only complicates the consideration and does not obviate the fact that the ownership interest represents equity.

- Finally, we believe the basic ownership approach would be improved by a modification to paragraph 21, which discusses criteria under which instruments redeemable at amounts approximating fair value – i.e., book value – would be classified as ownership instruments. With respect to ownership instruments that a company has no obligation to redeem (i.e., its board of directors has the right to deny any redemption request), the FASB's approach does not seem to place any constraints on the amount at which such instruments might ultimately be redeemed in the event its board chooses to permit redemption. In future deliberations leading to an Exposure Draft, we request the FASB to explicitly clarify that the amount at which redemption of ownership instruments occurs does not impact the liability versus equity analysis as long as a company is under no obligation to redeem such instruments. In conjunction with this view, we believe the basic ownership approach would be improved by a modification to paragraph 21 to provide for its application to ownership instruments regardless of whether or not they are considered mandatorily redeemable. This would add simplicity and clarity to the criteria used in evaluating an instrument's classification as a basic ownership instrument under the basic ownership approach.

### **Ownership-Settlement Approach**

Unified agrees with the Board's position that this approach is less preferable than the basic ownership approach due to its complexity. This approach does not impact Unified's equity classification other than to potentially define our classes of stock as perpetual equity instruments rather than basic ownership instruments.

### **Reassessed Expected Outcomes Approach**

The reassessed expected outcomes approach is not expected to have a great deal of relevance for book value companies and cooperatives, since the shares of stock evidencing Members' basic ownership interest in the cooperative are valued at book value or Exchange Value, and their measurement does not involve any counterparty's payoff that is directly or inversely related to the price of other basic ownership instruments. Were cooperatives or book value companies to employ derivative instruments with the price of the company's own basic ownership instrument as the underlying value, they would constitute equity derivatives as defined and would be treated as equity in any event.

### **Summary – Conclusions**

In consideration of the issues discussed in the foregoing, Unified respectfully requests the FASB to address the following during its deliberations of comments received on the Preliminary Views document:

- Eliminate the requirement in paragraph 18 (b) that basic ownership instruments have “*no upper limit except for the amount of assets available.*”
- Adopt an approach consistent with that of IFRIC 2 with respect to cooperative entities, whereby “*Members' shares are equity if the entity has an unconditional right to refuse redemption of the members' shares.*” Since IFRIC 2 has already been accepted in the international standard-setting community, we believe that adoption of this approach would further the goal of moving toward convergence with international standards while also addressing the concerns of book value cooperative organizations.
- Incorporate components of the loss-absorption approach as presented in Sections 3 and 4 of the PAAinE discussion paper into the upcoming Exposure Draft as part of the criteria in determining classification under the basic ownership approach. We refer specifically to the assertions that “*loss-absorbing capital serves as a buffer or cushion in protecting the claimants of non-risk capital,*” and “*participation in losses is the decisive factor in distinguishing risk capital from all other types of capital.*” Further, we believe this approach should be considered by the FASB because it allows for more forms of equity interest, meets the goal of decision useful information for investors, and can meet the needs of all forms of corporate structure while advancing the FASB goal of simplifying the complexity associated with classifying equity instruments.

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- Modify paragraph 21 to provide for its application to equity instruments regardless of whether or not they are considered mandatorily redeemable. This would add simplicity and clarity to the criteria used in evaluating an instrument's classification as a basic ownership instrument under the basic ownership approach.

If you have any questions concerning any aspect of the foregoing, please do not hesitate to contact me directly at (323) 264-5200 (ext. 4281).

Very truly yours,



Richard J. Martin,  
Executive Vice President,  
Finance & Administration,  
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