

Accounting Standards Board

Policy Proposal: The Future of UK GAAP

Response from the Association of British Credit Unions Limited

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1. Introduction

- 1.1 We welcome the opportunity to respond to this consultation. ABCUL represents 70% of credit unions in England, Scotland and Wales who in turn represent 85% of credit union membership. ABCUL is the main trade association for credit unions in Britain. Credit unions are not-for-profit, financial co-operatives owned and controlled by their members providing safe-savings and affordable loans facilities. Increasingly credit unions offer more sophisticated products such as current accounts, ISAs, Child Trust Funds and mortgages.
- 1.2 At the end of June 2008, credit unions in Great Britain were providing financial services to 655,000 adult members¹ and had £429 million out on loan to members.
- 1.3 In June 2009, the 325 credit unions belonging to ABCUL were managing around £450 million of members' savings on behalf of over 550,000 people, and had approximately £370 million out on loan.
- 1.4 The Credit Unions Act 1979 sets down in statute the objects of a credit union; these are four-fold:
- The promotion of thrift among members;
 - The creation of sources of credit for the benefit of members at a fair and reasonable rate of interest;
 - The use and control of their members' savings for their mutual benefit; and
 - The training and education of members' in the wise use of money and in the management of their financial affairs.
- 1.5 Credit unions in Britain are small, co-operative financial institutions often extending financial services to those unfairly excluded from the financial services the majority take for granted. They are owned and controlled by a restricted membership and are operated for the sole benefit of this membership. The Credit Union Act 1979 sets down these operating principles in law. The central, local and devolved governments of the UK have consistently supported credit union expansion and development in recognition of the benefit that they provide.

2. Credit unions and Financial Inclusion

- 2.1 Because credit unions only exist to meet the needs of their members and pride themselves on providing inclusive financial services in the communities they serve, they have consistently been placed centre stage in Government's Financial Inclusion Strategy and Action Plan.
- 2.2 Credit unions are tasked with extending the reach of affordable credit and are supported in doing so by the Financial Inclusion Growth Fund, which provides capital for on-lending through credit unions and community development finance institutions (CDFIs). This fund is administered by the

¹ Figures from unaudited quarterly returns provided to the Financial Services Authority

Department for Work and Pensions (DWP) and, after the addition of £18.75 million in last year’s budget, has provided almost £100 million to extend the reach of affordable credit.

- 2.3 In addition to this, ABCUL and two of our member credit unions are delivery partners for the FSA’s ‘Moneymadeclear’ money guidance pathfinder. This provides people with impartial money guidance to improve consumer confidence and decision making. Both the Government and the Conservative financial services white papers have pledged their support to rolling this service out nationally and ABCUL are committed to promoting further engagement of credit unions with the service as a means to better complement our statutory responsibility to promote financial capability within our membership.
- 2.4 Credit unions are also keen to offer Saving Gateway accounts to their members, when this new matched savings scheme for people on lower incomes is launched later in 2010.
- 2.5 In the course of these inclusive activities, our members make affordable credit available to their members, often in competition with predatory, high-cost lenders – credit unions do not ‘price for risk’ in the same way but charge reasonable rates of interest.
- 2.6 Any move by a statutory body which burdened the development of credit unions without providing any discernible benefit would therefore be inconsistent with the overarching strategy of Government and its statutory agencies to support and encourage the activity of credit unions and their continued expansion.

3. Size and current regulatory and legal status

- 3.1 Credit unions in Britain are small, co-operative financial institutions often extending financial services to those who may be excluded from mainstream financial services. They are owned and controlled by a restricted membership and are operated for the sole benefit of this membership. The Credit Union Act 1979 sets down these operating principles in law. The central, local and devolved governments of the UK have consistently supported credit union expansion and development in recognition of the benefit that they provide.
- 3.2 Internationally, credit union development is inconsistent. Market penetration, movement size and average credit union size in some countries is extensive in comparison with here in Great Britain.

Country	Market Penetration	Total Assets (USD)	Average Assets (USD)
Ireland	74.8%	19,466,966,827	38,320,800
USA	43.7%	825,812,776,839	103,629,156
Canada	47.3%	185,046,002,862	183,577,383
Australia	24.2%	31,349,959,619	256,966,882
Great Britain	1.5%	856,778,974	1,811,372

Figures from WOCCU – Statistical Report 2008 (www.woccu.org)

- 3.3 The uniquely local nature of credit unions in Great Britain needs to be taken into account when determining reporting standards for credit unions. In many countries in Europe, credit unions are

largely non-existent – in countries such as France and Germany, for example, the Co-operative Bank model is the norm.

3.4 ABCUL has worked together with the European Network of Credit Unions to raise understanding in Europe on credit unions’ unique structure.

3.5 This unique structure of credit unions has been recognised by the European Union and this has led to exemption from a number of European Directives, including exemption from the Capital Requirements Directive under Article 2.4. The most recent example of this is the Consumer Credit Directive. Member states are able to exempt credit unions from the requirements of the Consumer Credit Directive because they meet the following definition:

5. Member States may determine that only Articles 1 to 4, 6, 7 and 9, Article 10(1), points (a) to (h) and (l) of Article 10(2), Article 10(4) and Articles 11, 13 and 16 to 32 shall apply to credit agreements which are concluded by an organisation which:

(a) is established for the mutual benefit of its members;

(b) does not make profits for any other person than its members;

(c) fulfils a social purpose required by domestic legislation;

(d) receives and manages the savings of, and provides sources of credit to, its members only; and

(e) provides credit on the basis of an annual percentage rate of charge which is lower than that prevailing on the market or subject to a ceiling laid down by national law, and whose membership is restricted to persons residing or employed in a particular location or employees and retired employees of a particular employer, or to persons meeting other qualifications laid down under national law as the basis for the existence of a common bond between the members.

3.6 Credit unions are also exempt from the Consumer Credit Act under the **The Consumer Credit (Exempt Agreements) (Amendment) Order 2006**. This is due to the interest rate cap contained in the Credit Unions Act 1979. The cap was amended in 2006 and is set at 2% a month on the reducing balance.

3.7 From the most recent financial data available to us from 2008, every single credit union in Britain fell below the Financial Reporting Standards for Smaller Entities thresholds for both turnover and staffing – the very largest credit union generated less than £5 million in turnover and employed less than 30 staff. The following represents an analysis of 281 annual returns from 2008:

Turnover	Number of CUs
<100k	168
>100k <200k	57
200k <500k	38
500k <1m	9
1m <5m	9

Staff	Number of CUs
<5	164
>5<10	16
>10<30	12

- 3.8 Whilst we acknowledge that your proposals discount size as a relevant factor in determining whether or not full IFRS should be applied, the unsuitability of full IFRS for organisations as small as British credit unions cannot be escaped. Only 192 credit unions employ any staff at all – their resources are not geared to complying with this level of disclosure; most lack any in-house accounting resource or software.
- 3.9 The Institute of Chartered Accountants for Scotland (ICAS) dispute whether public accountability alone is a suitable categorisation with no recourse to size:

*The Institute's key concern with the proposal in paragraph 2.3 is that the definition could result in **small localised credit unions** and mutual societies, who have a membership limited to a restricted group, being classed as publicly accountable. These bodies will currently be preparing financial statements under the UK GAAP and requiring them to prepare financial statements under full IFRS would be disproportionate and the benefit to stakeholders minimal. The Institute fundamentally disagrees that these bodies are "publicly accountable". It is possible that these bodies would be exempt by virtue of their services not being for a "broad group of outsiders" but we are concerned that this definition leaves much to the exercise of judgement.*

The Institute proposes an addition to part (ii):

and does not meet two of the following three criteria:

Turnover	Not more than £6.5m
Balance Sheet Total	Not more than £3.26m
Number of Employees	Not more than 50²

4. Public Accountability

- 4.1 British credit unions cannot be described as publicly accountable – as self contained financial co-operatives they are only accountable to their membership.
- 4.2 This membership is drawn from a restricted pool – those sharing a common characteristic or 'common bond': living or working in a certain area, working for a certain employer or belonging to a certain association. The credit union board of directors is elected from the membership, by the membership. The ABCUL credit union model rules stipulate that directors of credit unions should be unpaid – only a credit union treasurer can receive an honorarium.
- 4.3 Given the co-operative structure of a credit union and its restricted potential membership it cannot be deemed publicly accountable – it is only accountable to its membership. The Institute of Chartered Accountants for England and Wales supports this analysis.

² Excerpt from ICAS' draft response to this consultation – January 2010.

4.4 Under FSA regulations, the largest common bond permissible currently is a potential membership of 1 million people – under legislative and regulatory reforms, currently awaiting parliamentary approval, this will rise to 2 million. This is the maximum, upper limit potential members– currently the largest credit union has less than 25,000 members.

4.5 Barclays Bank plc, according to their 2008 report, serves 48 million people,³ Royal Bank of Scotland, 40 million⁴ - these figures exclude the many equity investors that the two banks have.

4.6 The customer base of enormous banking organisations is not comparable to that of even the largest British credit union. We would therefore dispute that a credit union with restricted membership should be deemed to be publicly accountable on these terms. On this point the Institute of Chartered Accountants in England and Wales (ICAEW)'s draft response states:

*At present we envisage a number of types of entity falling within this definition - and thus being subject to the full rigours of the IFRS reporting regime - where the costs involved may significantly outweigh the benefits, for example some deposit-taking businesses and small friendly societies and **credit unions**. In practice full IFRS financial statements are probably only relevant to the regulators of such institutions, not their members (as they are perhaps likely to require simplified information in order to understand the performance of the entity). This raises a question as to what publicly accountable means in terms of being linked by definition to the need to produce full IFRS accounts, when financial statements are produced primarily for members.⁵*

4.7 Furthermore, where ICAEW suggest that the only potential beneficiary of these changes is the regulator – we feel that the regulator's information submission processes already fulfil their needs (see: 6. *Effect of Proposals*). ICAEW suggests that the regulator – the FSA – should decide whether or not to apply IFRS standards:

One solution might be to permit specified types of reporting entities, which are not subject to the Accounting Directives and operate in sectors where reporting requirements are determined by UK regulators in the public interest to use the IFRS for SMEs (or, where applicable, the FRSSE), with the proviso that the regulator will determine whether certain entities within its remit should report under a higher tier. We believe that the Board should discuss this issue with relevant regulators, in order to determine the appropriate regime in each case, or possibly to find a more nuanced approach to what publicly accountable means for these entities and their regulators.⁶

³ See: <http://www.barclaysannualreport.com/ar2008/index.asp?pageid=107>

⁴ See http://files.shareholder.com/downloads/RBS/826828100x0x278478/df821101-a4f3-459b-80a8-a45141002a84/RBS_Annual_Review_2008_09_03_09.pdf

⁵ See: http://www.icaew.com/index.cfm/route/169252/icaew_ga/Faculties/Financial_Reporting/UK_GAAP/Consultations/The_future_of_UK_GAAP_ICAEW_draft_response/pdf

⁶ Ibid.

4.8 The FSA has already determined the level of disclosure it requires and we understand that the level of disclosure Tier One IFRS would require would not improve their ability to monitor regulatory compliance.

5. Effect of Proposals

5.1 We feel strongly that applying full IFRS to credit unions will not provide any benefit to credit union members, credit unions themselves, the general public or the regulator. At the same time it would impose significant costs upon already stretched social enterprises.

5.2 Those practically interested in the financial position of credit unions fall into 3 categories: members, management and directors and regulators. None of these groups will benefit from the move to full IFRS standards.

5.3 The membership of a credit union is made of people using the services of the credit union who, whilst having a democratic right to control the credit union's operations, rely heavily on the credit unions' paid staff and/or officers and the regulatory body – the FSA – to ensure the organisation's financial health. In the experience of our membership and the auditors we have spoken to, the audited accounts at present are too difficult for many members to comprehend – to add an extra layer of complexity to this would not improve the situation for the membership.

5.4 A core objective of IFRS accounts is to ensure international comparability – for the vast majority of British credit union members or potential members, however, not only is international comparison entirely irrelevant but any comparison at all is impossible. Due to the nature of the restricted membership criteria, most individuals who qualify for credit union membership will only fulfil the criteria for a single credit union and therefore have no choice and no reason for comparison.

5.5 Furthermore, in the limited areas where there is a choice (for example, in Glasgow or Merseyside) the obscurity of full IFRS would make this more difficult than needs be. UK GAAP or IFRS for SMEs provides a much more suitable basis for any comparison for a lay-person.

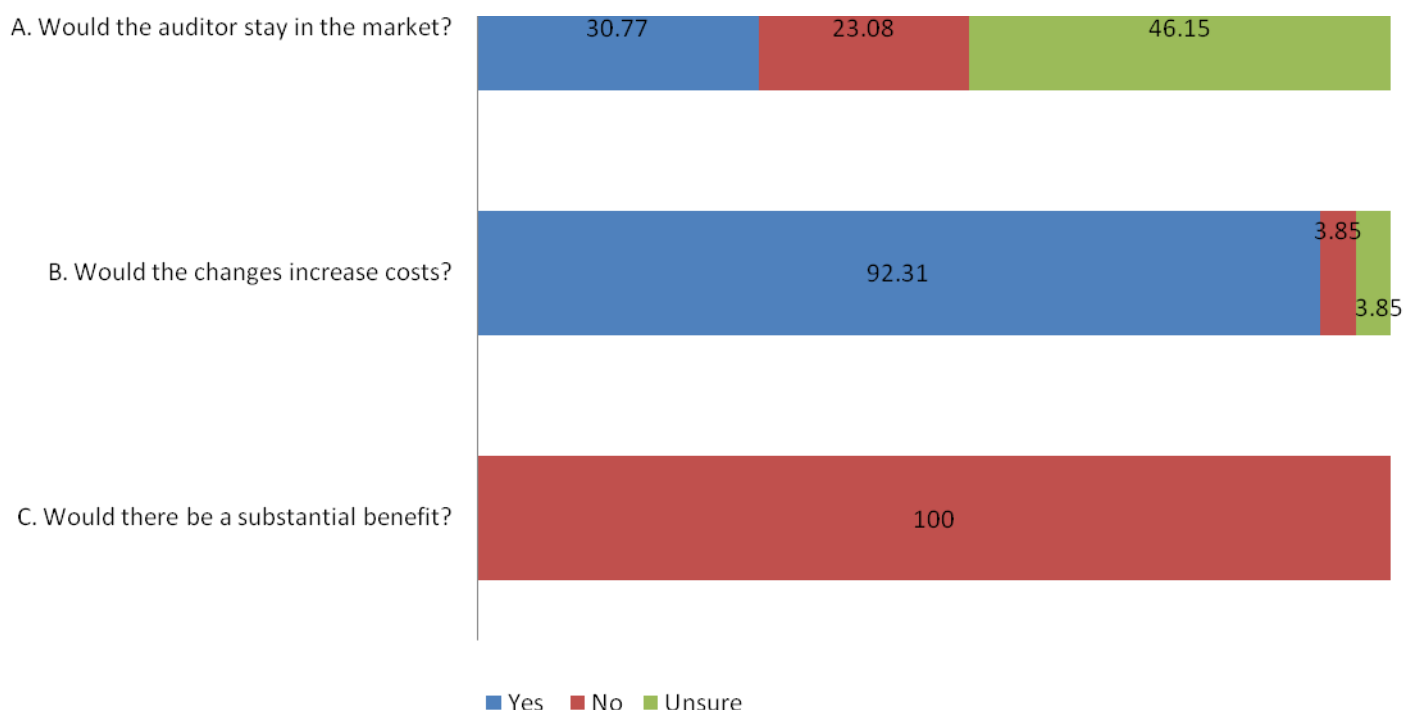
5.6 It is the opinion of the auditors that we have consulted that the volunteer board of directors at most credit unions would find IFRS substantially more difficult to understand and apply than present standards – given that many rely entirely on volunteers and lack the accounting resources necessary, this will only push many credit unions to pay for the services of accountants to help them decipher, implement and operate the new standards. The impact this could have on fees could very well push some credit unions out of business entirely. **If fees were to double, the entire operating profit of around 40 of our members would be wiped out.** Others would be unable to pay a dividend to their members, leading to a possible reduction in savings and a subsequent reduction in the amount the credit union could lend – this would also lead to a reduction in income.

5.7 The FSA require the submission of unaudited quarterly and audited annual financial returns and annual accounts to monitor compliance with their prudential regulations. The disclosures in the CY

(annual return) form used for this relate precisely to each prudential standard and provide all the necessary information that the FSA requires to ensure that a credit union is compliant. We understand that, should the FSA require any further information, it has the ability to consult and change standards of its own accord – as it is doing now, to change reporting requirements to reflect new powers being brought in by Legislative Reform Order. We believe that there is no discernible benefit for the FSA as regulator in having the extra disclosures that IFRS provides and we believe that it is questionable whether the FSA has the resources in place to analyse further credit union information. We believe that the FSA already receives all the information it needs.

5.8 In a survey of credit union auditors we found the following:

- 5.8.1 **38% (26)** of CU auditors responded
- 5.8.2 Representing approximately **55% (265)** of CU audits
- 5.8.3 We asked the auditors 3 questions relating to the possibility of credit unions move to Tier One IFRS reporting standards



5.8.4 Only **31%** of respondents would definitely continue in the market for CU auditing/accounts if full IFRS were applied – **23%** would leave the market and **46%**

would have to seriously reconsider. Already auditors struggle to make a profit from working with credit unions – a cost increase is likely to make the work uneconomic.

5.8.5 **92%** felt that the cost of CU accounts and auditing would increase under IFRS – only **4%** were unsure and **4%** thought not.

5.8.6 **100%** of respondents felt that there would be *no substantial benefit* for anyone involved in credit unions if full IFRS was applied – members, directors or regulator.

5.9 We can see no discernible benefit gained from applying full IFRS to credit unions. This is backed up by our member credit unions and the experience of the majority of credit union auditors by proportion of credit unions served. Substantial and potentially damaging cost increases will be incurred without increasing the safety of credit unions. This change would also have the effect of making credit union accounts less and not more transparent to the main group of people who have an interest in them – the credit union members who own the co-operative.

5.10 Should any form of IFRS (full or for SMEs) be applied to credit unions in Great Britain, considerable support will be needed from the ASB in implementation. In particular, IFRS 7 and its likely implications for loan-book accounting is likely to represent a significant change and one that neither the credit union sector nor the vast majority of accountants and auditors advising them have any real experience of.

6. Conclusion

6.1 We do not believe that credit unions in Great Britain should be defined as publicly accountable. Although they are Deposit Takers with a part IV permission from the FSA, they are recognised by the UK Government and by the European Union as having a unique structure which already leads to exemptions from the Consumer Credit Act, Banking Directives and the Consumer Credit Directive.

6.2 As member owned and controlled financial co-operatives, they operate in a transparent fashion and members have opportunities through the democratic processes built into credit unions' legal structures to obtain information about the financial health of the credit union. A move to Tier One disclosure will make credit union accounts less transparent and understandable to the lay membership. Credit unions are fully accountable to their members and are not accountable to the general public.

6.3 Credit unions are regulated by the Financial Services Authority, which requires regular financial returns to ensure that credit unions are meeting prudential standards – extra disclosure will not add anything to the information that the FSA receives from credit unions.

6.4 The notion that credit unions should conform to full IFRS is inconsistent with the ASB's principles of regulation: it is **disproportionate** in that it provides no benefit whilst imposing significant cost burdens; it is **unaccountable** in that it makes no reference to the reality of British credit unions; it is **inconsistent** in that it wrongly applies public accountability to credit unions, accountable only to a pre-defined, select group; it is **not transparent** in that it further clouds the comprehensibility of

credit union accounts for the lay-member; and it is **not targeted** in that it applies standards created for large publicly quoted companies to small, local social enterprises.

6.5 There is already a limited market for credit union audit and our research shows that there is a severe risk of withdrawal from the market and cost increases for credit union audits. In a small, developing sector there is a risk that this would put a severe burden on credit unions' limited resources. This could lead to reduction in services to members, many of whom are excluded from other sources of affordable financial services.

6.6 British credit unions will require significant direct support from the ASB should the move to full or, indeed, IFRS for SMEs be pursued. Neither the credit union sector nor the vast majority of accountants and auditors advising them have any real experience of IFRS and its implications.

6.7 We look forward to continuing to contribute to the ASB's deliberations on this issue to find a mutually agreeable solution which will ensure credit unions continue to report their financial position fairly and transparently, in a way which is understandable to credit union members and which meets the needs of the regulator. We strongly believe that a move to Tier One would not bring benefits to anyone involved and will have adverse effects for the sector.

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