Accounting Quality and Accountability in Credit Unions in Northern Ireland

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&

Professor Anne Marie Ward (presenting today)

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Project Background – CUs

- Credit unions are unique financial institutions. They are co-operatives that focus on providing credit and savings facilities for their membership.

- Northern Ireland Statistics (Bank of England, 2017):
    - 150 credit unions.
    - 561,001 persons with member (30.13% of relevant population).
    - Total assets of £1.6 bn
    - Member shares of £1.33 bn

- Regulation:
    - Prudential Regulatory Authority (PRA)
    - Financial Conduct Authority (FCA)
    - Credit Unions (Northern Ireland) Order 1985
    - Companies Act 2006

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Project Background - accountability

- Why is accountability important to the credit union sector?
    - Volunteer members
    - One member one vote rule
    - No dominant shareholders or institutional investors
    - Not listed companies
- Effective discharge of accountability required to provide assurance over the effective and efficient running of <u>their</u> union.

- "Production of an annual report seen as a major part of the process of discharging accountability by the credit union to those outside its immediate management, including members" (Hyndman et al. 2001, p.109).

- Accountability: transparency, equity, democracy, efficiency, responsiveness, and integrity. (Mulgan, 2000, p.555)

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Overall aim of the research

- Research question:

“Is the annual report effective in discharging accountability?”

- Addressed through 3 research objectives

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Research Objectives

RESEARCH OBJECTIVE ONE:

- Investigate the quality of information provided in the annual report and financial statements of credit unions and whether the quality was influenced by the financial crisis (year end 2008), transfer of regulation (year end 2012), and the change of accounting standards to FRS 102 (year end 2015).

- Two steps:
    - Design an instrument of quality.
    - Use of the instrument to measure the quality of the information.

Research Objectives

RESEARCH OBJECTIVE TWO:

- To investigate the determinants of high quality annual reports in credit unions in Northern Ireland

RESEARCH OBJECTIVE THREE:

- Investigate whether stakeholder accountability requirements are currently being discharged by published annual reports and financial statements or by other means.
- Requires:
  - Establish the key stakeholders of credit unions in NI.
  - Determine their accountability needs.
  - Investigate whether needs are currently being met by credit unions/annual report.

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Overview of key literatures

- Research positioned within:
  - Stakeholder Theory
  - Accountability
  - Accounting Quality

Stakeholder Theory

- Hyndman et al. (2004) found that managers viewed members as the primary stakeholder.

- Study was consistent with prevalent literature on charities (Hyndman, 1991; Connolly and Hyndman, 2013a) that conclude that donors/contributors were undoubtedly observed as the most important stakeholder for charities and auditors alike.

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Accountability

- Accountability is the “requirement to provide evidence that autonomy is responsibly used and is the price of autonomy”.

- Accountability is intrinsically linked to the requirements of those who delegate the autonomy i.e. the stakeholders.

- Accountability is defined as “the means by which individuals and organisations report to a recognised authority and are held responsible for their actions” (Edwards and Hulme, 1996, p 967).
- Multiple types of accountabilities for multiple stakeholders (Ebrahim, 2003a) and therefore there is a need to account to all stakeholders.

- Multiple accountabilities can lead to “over accounting” to multiple demands of “under accounting” in that each stakeholder is assuming that others are monitoring the actions and results. (Edwards and Hulme, 1995).

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Accounting Quality

- Link to the requirement of quality: without quality the discharge of accountability may be ineffective.
- Quality is subjective and often depends on the actors involved in the situation.
- “Usefulness of financial statements to investors, creditors, managers, and all other parties contracting with the firm” (Ball and Shivakumar, 2005).
- Usefulness: empowering users to make judgements about accounting information (Power, 2013).

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Accounting Quality

- No general agreement as to how accounting quality should be measured (Hribar et al., 2014).
  - Earnings management
  - Disclosure quality

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Methodology

- Influences on current financial statements – create an analytical model – 3 layers of accountability.

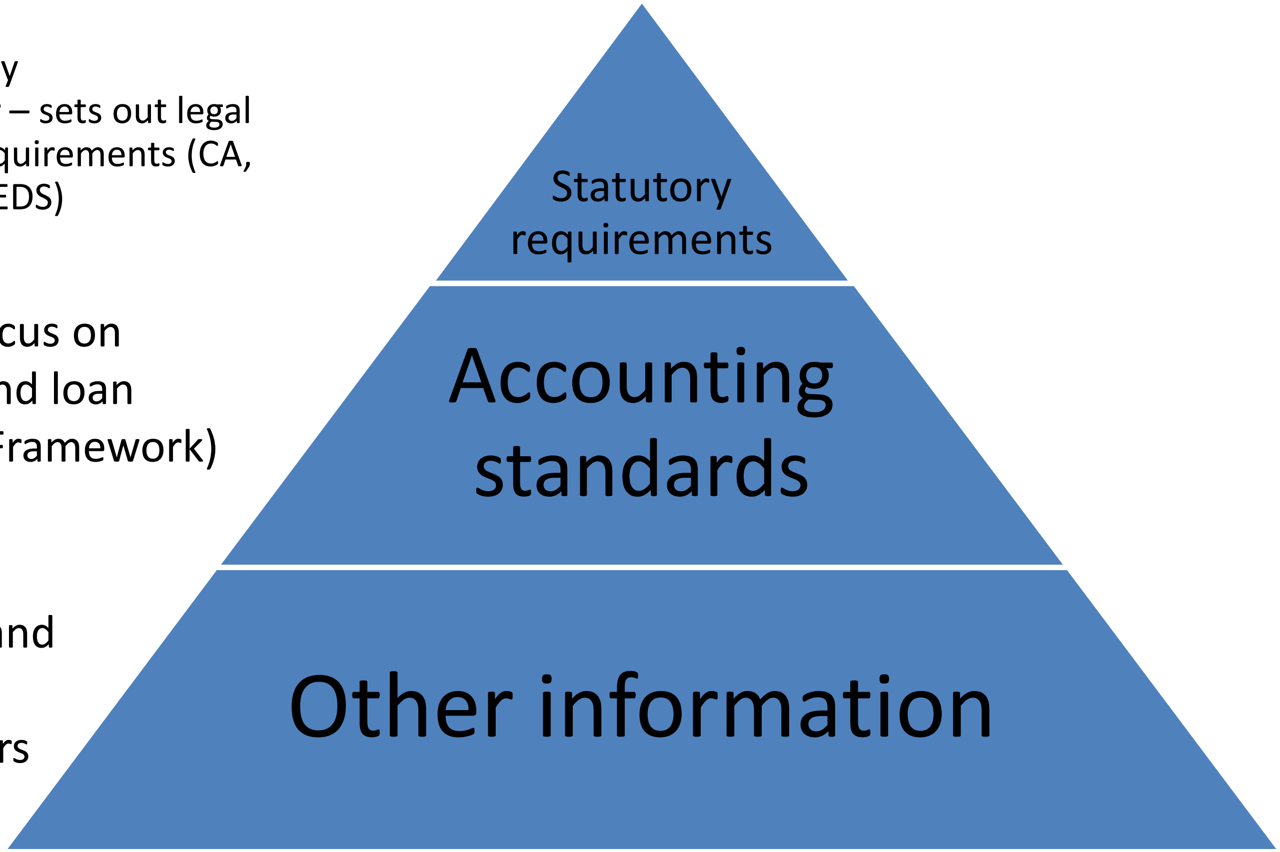
Analytical model

Discharge of accountability in annual reports

Predominately
the Regulator – sets out legal
Disclosure requirements (CA,
CU Order, CREDS)

Typically focus on
investors and loan
Creditors (Framework)

Members and
other
stakeholders



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Methodology

- Design a quality instrument – required, recommended and other disclosures.
- Content analysis of credit union annual reports
- Three year period (financial crisis - 2008, change in regulation - 2012 and FRS 102 – 2015).
- Data is available from Department for the Economy with 100% of the population available.
- Annual reports - analysed and coded to generate a quality score.

- The overall quality measure – used to investigate the determinants of quality financial statements.

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Disclosure source	Legislation	Standards	Other	Total
Narrative/Directors report	Out of 8 (%)	-	Out of 30 (%)	Out of 38(%)
Mean	3.65(45.61%)	-	4.58(15.28%)	8.23(21.66%)
Stdev	1.73(21.64%)	-	3.30(10.99%)	4.58(12.05%)
Audit report	Out of 6(%)	-	Out of 35(%)	Out of 41(%)
Mean	5.58 (92.96%)	-	15.33(43.79%)	20.90(50.99%)
Stdev	1.11 (18.56%)	-	2.60(7.42%)	3.61(8.81%)
Financial statements	Out of 13(%)	Out of 8(%)	Out of 102(%)	Out of 123(%)
Mean	7.89(60.71%)	6.08(75.97%)	38.05(37.31%)	52.02(42.30%)
Stdev	1.31(10.10%)	0.73(9.07%)	8.20(8.04%)	8.98(7.30%)
Accounting policies	-	Out of 17(%)	Out of 13(%)	Out of 30(%)
Mean	-	4.21(24.79%)	2.11(16.21%)	6.32(21.07%)
Stdev	-	1.53(8.99%)	0.94(7.19%)	1.99(6.64%)
Notes	Out of 8 (1%)	Out of 21(%)	Out of 193(%)	Out of 222(%)
Mean	2.14(26.71%)	3.58(17.04%)	37.02(19.18%)	42.73(19.25%)
Stdev	1.12(13.95%)	1.37(6.54%)	11.56(5.99%)	12.87(5.80%)
Total	Out of 35(%)	Out of 46 (%)	Out of 373(%)	Out of 454(%)
Mean	19.26(55.02%)	3.57(17.04%)	97.09(26.02%)	130.2(28.81%)
Stdev	3.65(10.43%)	1.37(6.54%)	19.26(5.30%)	23.69(5.24%)

Methodology

Ordinary least squares (OLS) regressions are utilised to investigate the determinants of accounting quality using the following model:

$$X_{ij} = (AS_i, AF_i, S_i, A_i, N_i, C_i, T_i) \qquad (1).$$
$$i = 1, \ldots, N$$

The dependent variable (X) measures financial management using four accounting disclosure quality: statutory compliance ($X_{1,i}$); accounting and audit standards compliance ($X_{2,i}$); additional stakeholder disclosures ($X_{3,i}$) and overall accounting disclosure quality ($X_{4,i}$).

The independent variables include:

1. Auditor size (AS_i)
2. Auditor fee (AF_i)
3. Size (S_i)
4. Age (A_i)
5. Number on the board (N_i)
6. Common bond (C_i)
7. Trade association (T_i)

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Results

Regression	Legislation	Standards	Other	Total
Observations	161	161	161	161
Constant	21.85*	26.66**	3.29	6.96
	(1.89)	(4.17)	(0.68)	(1.44)
Auditor (Medium)	1.27	1.67*	0.45	0.63
	(0.78)	(1.86)	(0.67)	(0.93)
Auditor (Large)	1.91***	8.21***	1.62	2.97*
	(2.97)	(4.04)	(1.06)	(1.93)
Audit fee (% of income)	0.30	-0.10	-0.05	-0.03
	(1.28)	(-0.78)	(-0.57)	(-0.33)
Size (log of total assets)	2.14**	0.30	1.63***	1.53***
	(2.86)	(0.73)	(5.23)	(4.88)
Trade association (UFCU)	1.28	-0.34	-2.61***	-2.08***
	(0.70)	(-0.34)	(-3.43)	(-2.71)
Trade association (Other)	3.49	1.99	0.64	0.99
	(1.24)	(1.27)	(0.54)	(0.83)
R-squared –Within	0.11	0.13	0.46	0.42
F-stat (Chi^2)	4.31	4.89	23.75	19.93
	(0.000)	(0.000)	(0.000)	(0.000)

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Robust t-statistics are in parentheses: * p<0.1; ** p<0.05; ***p<0.01

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Regression	Directors report	Audit report	Financial statements	Accounting policies	Notes
Observations	161	161	161	161	161
Constant	-0.16	33.17**	12.71	14.37*	-0.84
	(-0.01)	(4.14)	(1.58)	(1.97)	(-0.16)
Auditor (Medium)	1.62	0.42	-1.77	0.39	1.87**
	(0.79)	(0.37)	(-1.57)	(0.38)	(2.47)
Auditor (Large)	14.50***	0.58	-0.33	11.76***	2.07
	(3.13)	(0.23)	(-0.13)	(5.06)	(1.21)
Audit fee (% of income)	0.24	0.21	0.12	-0.10	-0.20*
	(0.81)	(1.31)	(0.72)	(-0.66)	(-1.81)
Size (log of total assets)	1.40	1.22**	2.09***	0.46	1.44***
	(1.49)	(2.35)	(4.02)	(0.97)	(4.13)
Trade association (UFCU)	-2.49	0.01	-2.15*	-1.03	-2.50***
	(-1.07)	(0.01)	(-1.69)	(-0.89)	(-2.92)
Trade association (Other)	5.56	0.72	-0.10	1.80	0.74
	(1.56)	(0.36)	(-0.05)	(1.01)	(0.56)
R-squared –Within	0.10	0.02	0.20	0.19	0.45
F-stat (Chi^2)	4.10	1.50	7.72	7.09	22.97
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Interesting findings
Varied treatment

- Members share capital

Treated as equity	122	(72.6%)
Treated as current liability	41	(24.4%)
Treated as long term liability	7	(4.2%)

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Interesting findings

Varied treatment

- Dividends

Accrued	26	(15.5%)
On statement	12	(7.1%)

Information on dividends/policy

Accounting policy	13	(7.7%)
Directors report	78	(46.4%)
Notes	94	(56.5%)

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Interesting findings

Varied treatment

- Bad debts/provision

Accounting policy	111	(66.1%)
Expenses	104	(61.9%)
Income	1	(0.6%)
Note (movements)	30	(15.5%)

Bad debts recovered

Income	92	(54.8%)
Expenses (-ve)	12	(7.1%)

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Interesting findings
Varied treatment

- Other
    - Audit fee 34 (20.2%)
    - Loans to member note 84 (50%)

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Conclusion (preliminary)

- Auditor size is important (auditor quality)
- Size – resources are important? (staff or budget)
- Trade association is important (guidance/training/support)

- Some not complying with legislation
- Variation in treatment

- Our view – SORP required – guidance required – aid preparers – improve comparability and usefulness of annual reports as stakeholders typically have an input to the process.

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Questions