AN ANALYSIS AND A CRITICAL EVALUATION OF THE FINANCIAL MANAGEMENT OF CREDIT UNIONS IN BRITISH COLUMBIA

by

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ABSTRACT

The credit unions in British Columbia have experienced spectacular growth during the last fifteen years. Many new credit unions have come into existence and old ones have increased considerably in size. Different pieces of legislation, Federal as well as Provincial, have been passed to ensure safety of members' savings and efficient management of credit unions.

This study is an attempt to evaluate the financial management of credit unions in British Columbia. The evaluation has been made from the standpoint of financial soundness, lending practices, accounting system and system of internal control. Since a credit union is an important institution of consumer credit, a general discussion of consumer credit is presented in the beginning of the study.

Consumer credit is a major force in our modern economy. Mass production of goods at low costs has been greatly assisted through the advent of consumer credit financing. Modern credit theory divides the field of credit into three categories: emergency credit, convenience credit and instalment credit. Instalment credit is the most significant of these three in terms of its effect upon the economy. The level of this credit depends on the durables bought on an instalment basis, and the sale of durables depends on discretionary income, expectation of future income, the pattern of distribution of income amongst spending units and the growth of income. The

consumer credit market is imperfectly competitive.

Credit unions provide a significant portion of consumer lending in Canada. They have experienced a more than proportionate growth in their trend of instalment credit lending as compared with the growth trend of other lending institutions.

Since savings is the source of consumer credit, the role of credit unions as saving institutions has been studied. Credit unions now act as depositories for a significant portion of total net savings in Canada.

Cooperative central banking in Canada, through a recent development, is becoming increasingly popular. In 1953, a Canadian Cooperative Credit Association was formed to act as an apex organization for all the cooperative central banks in Canada.

The financial soundness of a credit union depends on the adequacy of reserves, liquidity, and growth. There are various types of reserves in existence, of which the reserve for bad debts is of material importance. Under the B.C. Credit Unions Act, the provision for bad debt losses has to be kept in liquid form. This seems to be an unnecessary provision because the function of the reserve fund is to absorb losses, and because such losses do not necessitate the payment of cash. Total bad loans have been related to loans outstanding and the reserve fund. The overall position has been studied and is considered to be very satisfactory.

For measurement of the growth of credit unions, the time series of savings, membership and loans have been analysed by the Gompertz curve method. The annual increase in all the three factors is at a declining rate. The projection of Gompertz curves indicates that it will be a long time before a period of stability is reached.

The liquidity of credit unions is analysed by relating the total funds retained to the legal requirements. In almost all cases funds retained are higher than the legal requirements. The effect of the seasonal pattern of demand for borrowings on liquidity has been studied from the statistics obtained from the books of B.C. Central Credit Union. Since B.C. Central Credit Union is the depository of funds of most of the credit unions in British Columbia, their liquidity is directly related to B.C. Central's. B.C. Central's liquidity has been analysed from the standpoint of lending practices, the extent of exercise of the borrowing rights and its compliance with the statutory requirements.

The lending practices of credit unions have been studied from the standpoint of the purposes for which loans have been granted, the nature of security taken, the rate of interest charged, and the terms of repayment of loans. Purchase of durables, and real estate constitute more than 60% of the borrowings from credit unions. The effective rates of interest charged by credit unions have been compared with the rates of other lending institutions. The lending of credit

unions is kept reasonably on a short-term basis.

In order to study accounting systems and the system of internal control, a number of credit unions in Vancouver were visited. The study was made from the standpoint of three management objectives: namely, managerial decision-making, protection of assets and determination of income. Though the systems in use are thought to be reasonably satisfactory, some small credit unions are not making proper use of them.

Throughout the study, recommendations have been made that are thought to be helpful in improving the financial management of credit unions in British Columbia.

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INTRODUCTION

Speaking to the twenty-first British Annual Cooperative Congress, Alfred Marshall, the most influential economist of his time, stated about the cooperative movement:

> It combines high aspirations with calm and strenuous action, ... it sets itself to develop the spontaneous energies of the individual while training him to collective action by the aid of collective resources, and for the attainment of collective ends. It has points of affinity with many other movements; but it is like no other.
>
> Other schemes for developing the world's material resources are equally practical and equally businesslike, but they have not the same direct aim to improve the quality of man himself. Other schemes for social reforms have equally high aspirations but they have not the same broad basis of patient action and practical wisdom .... It is at once a strong and calm and wise business, and a strong and fervent and proselytising faith.[1]

A credit union is the true embodiment of this thought. In the light of such a quotation, it is no wonder that credit unions in Canada amassed more than a billion dollars in one generation, and that the membership rose to 13% of the total population by 1958. Table A shows the rate of growth of membership and assets of Canadian credit unions.

All this progress was made without any profit motive. John T. Croteau, while considering the psychology of human action states:

> There are other motives than the profit motive in human action. Great thinkers have appreciated this fact. Possibly the credit union has succeeded in

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[1]John T. Croteau, The Federal Credit Union Policy and Practice, Harper and Brothers Publishers, New York, 1956, p. 3.

attracting leaders who are appealed to by 'some great idea or elevated sentiment'. Probably the majority of credit union officials would disclaim such high motivation; few of them wear their hearts on their sleeves. Some say that they find the work interesting, others work out of a sense of duty to the group, and still others can use the extra income from the outside employment which the credit union affords. In the last analysis, the real reasons for human action remain unknown even to oneself.[2]

TABLE A

GROWTH OF CREDIT UNIONS--CANADA 1940 TO 1958

Year	Credit Union Membership	Total Membership as a Percentage of Total Population	Assets Millions of Dollars
1940	201,137	1.8	25
1945	590,794	4.9	146
1950	1,036,175	7.5	312
1955	1,731,328	11.1	653
1956	1,870,277	11.6	761
1957 a	2,059,835	12.6	846
1958 b	2,212,698	13.0	1,008

a Revised for Ontario
b Estimated for Ontario

Source: Economic Division, Canada Department of Agriculture, Credit Unions in Canada, 1958.

A credit union is an institution of personal finance operating under the charter and supervision of a Provincial

[2]John T. Croteau, op. cit., p. 4.

Government, owned and managed by the membership united under a common bond, for their mutual benefit. It has a dual function, economic as well as social. As an economic unit, it provides its members with saving facilities, and then from the pooled savings makes available to them personal loans at a minimum cost. It is a non-profit organization.

The social impact of credit unions is equally important. It affords an opportunity for people to join together to serve the needy through the techniques of democratic and cooperative action. It gives a useful experience to the membership to run their own affairs and observe the results of group action in the betterment of the community. It helps in inculcating the habit of thrift in its members. New methods are being developed to help members solve their financial problems.

More and more credit unions are now thinking of providing their members with family financial planning counselling services. Some credit unions in the United States give training to the officials who interview the applicants for loans. Some are attempting to solve this problem from the preventive aspect of financial planning--that is, submitting financial plans to families that will prevent monetary problems from arising.[3]

In British Columbia, a credit union can be formed by any ten persons who belong to an eligible group. An eligible group is a group of persons who have a common bond of occupation or association, or form a group within a community in a certain

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[3] E.A. William, "Federal Credit Union Twenty Five Years of Self Help Security", appeared in Social Security Bulletin, June, 1959, p. 13.

neighbourhood, or rural or urban district.

Three committees, namely, a board of directors, supervisory committee and credit committee manage the affairs of a credit union. These are all elected by the membership. Some credit unions have an education committee as well which may be elected by the membership or appointed by the board of directors. The B.C. Credit Union League is a voluntary association of most of the credit unions in the Province. The "League" is affiliated with the Credit Union National Association whose name belies itself, because in reality it is an international association of Credit Unions. A brief description of the functions of credit union committees may facilitate an understanding of the financial management to be developed in this study.

The Board of Directors has the general management of the affairs, funds, and transactions of the credit union. The executive powers of the organization are vested in the board. The board appoints the treasurer who is in a sense the general manager of the union. The duties of the credit committee involve the consideration of loan applications and an approval or disapproval of the same. They must keep themselves informed about the patterns of repayments by different categories of borrowers and by different categories of loans. The supervisory committee is the auditor of a credit union. It is required to examine the books of accounts quarterly and submit a report to the Inspector as to the state of affairs of the credit union.

The supervisory committee is required to hold, or cause to be held, by a chartered accountant or any person approved by the Inspector of Credit Unions, Government of British Columbia, a detailed annual audit wherein it has to express an opinion regarding the financial position of the credit union. Its duties will involve an examination of the books, an inspection of securities, supervision of the acts of Board of Directors, the Credit Committee and employees of the credit union. The supervisory committee is not subject to the orders of the board, but the board has the responsibility of taking action to correct situations pointed out to it by the supervisory committee. While the board does not direct the supervisory committee, it is concerned with compliance with the B.C. Credit Unions Act, which requires the supervisory committee to perform periodical audits. The board has to see that the supervisory committee discharges its statutory obligations. The duties of an Education Committee are to maintain close liaison between the executive and the membership and to help the members appreciate the obligations which the management owes to them, and the obligations which they owe to the management.

The purpose of this study is to evaluate the financial soundness and the lending practices of credit unions in British Columbia. Different phases of their operations will be studied in order to assess their financial management, and where possible, to make recommendations to improve the financial policies and practices. Statistical data, collected from various sources, has been analysed. The main sources of information have been the B.C. Credit Union League, the Inspector of Credit Unions, Government of British Columbia, the Economics Division of the Federal Department of Agriculture, and Credit Union National Association.

In Chapter I, the thesis is initiated with a discussion of the impact of credit unions on the Canadian economy.

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CHAPTER I

THE PLACE OF CREDIT UNIONS IN CONSUMER CREDIT

> No benevolent man ever lost altogether the fruits of his benevolence. If he does not always gather them from the persons from whom he ought to have gathered them, he seldom fails to gather them, and with a tenfold increase from other people.
>
> Adam Smith, Theory of Moral Sentiments

Having considered the philosophy and organizational structure of credit unions, the next step is to evaluate the place of credit unions in consumer credit. This Chapter presents a brief discussion of the economics of consumer credit, motivation of a credit union member to save, the comparative position of credit unions with other lending agencies in Canada, cooperative central banking in Canada and governmental (Federal and Provincial) regulation of activities of the British Columbia Central Credit Union.

I. THE ECONOMICS OF CONSUMER CREDIT

The development of mass production methods made possible a large output at low costs. The consumption rate had to be stepped up to give impetus to further development and improvement of mass production methods. Consequently, to create a market for an increased supply of goods, an extensive use of consumer credit was made. In order to penetrate into different income groups, various credit techniques were evolved which would adapt different terms of sale to suit the needs of the consumer. Several lending institutions came into existence. There was a brisk competition in the credit field. Because the price of consumer credit is interest or charges, one would think that the only consideration for a consumer at the time of borrowing would be the cost of the loan, and so this would be a perfectly competitive market situation. However, this is not true; in point of fact, the consumer credit market is far from being perfectly competitive. The relationship between borrower and lender is governed by factors such as the economic status of the borrower, the security for the loan, and the geographical location which restricts the function of price competition in the consumer market. Because of the legal restrictions on the rate of interest on personal loans, the loan market is not a free market. The most important reason for imperfection in the consumer credit market is that it is a seller's market. The borrower does not want to shop around because he wants as few people as possible to know his financial weakness. Sometimes he does not know how and where to shop around. Further, usually the borrower needs money in a hurry, and whosoever is first to make it available to him obtains his business.

There is other evidence of imperfect competition in the consumer market. Although it seems to be competitive on the surface, there is very little cutting down of rates to secure more business. It is generally believed in banking circles that expenses increase more than proportionately with an increase in the volume of loans, resulting in an increase in income at a negative rate, or an actual decline in total income.[1] Competitive rate cutting is also restricted by low elasticity of the demand curve of the services of any one lender. By low elasticity it means that the percentage increase in loan demand from a particular lender will be less than the percentage reduction in rate. Borrowers generally have a tendency to stick to the same lender under all circumstances. To substantiate this viewpoint W.F. Lougheed draws support from the findings of L.N. Robinson and Maude E. Stearns in "Ten Thousand Small Loans" (Russel Sage Foundation 1930).

In Ten Thousand Small Loans the low elasticity of demand was pointed out:

> 70% of all loans were made to persons who had borrowed previously at the same office. The remainder, then, about 30 per cent, had had previous loans from the same office but had been able to

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[1]W.F.Lougheed, "The Economics of Credit," Credits and Collections in Canada, The Ryerson Press, Toronto, 1953, p.19.

pay them off before borrowing again.[2]

In the long run probably the consistent lower rates of a lender might attract borrowers away from other lenders.

An important point in consumer credit is whether the present consumption at the commitment of future savings is economically justifiable. Until the beginning of the Twentieth Century, the desire to avoid debt under all circumstances, and to finance purchasing of assets out of the savings of the family, dominated consumer expenditure. It caused a thrifty family to do without economic goods for a major portion of its life in order to save. When it accumulated enough savings to buy certain durable goods, its members were usually too old to derive full benefit from them. Saving as an economic term means "abstaining from the use of economic goods. It means consuming less than is being produced.[3] Since by consumer credit, future savings are consumed in the present, the question arises whether or not consumer credit impedes the rate of future savings of a family. The effect of consumer credit on savings is important because industrial development and prosperity depends on savings of the community. There are two opposite view points.

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[2]W.F. Lougheed, "The Economics of Credit", Credits and Collections in Canada, The Ryerson Press, Toronto, 1953, p. 19.

[3]Wilbur C. Plummer, "Social and Economic Consequences of Buying on the Instalment Plan", American Academy of Political and Social Science, 1927, p. 31.

Some people believe that consumer credit leads to saving. A family which would not otherwise save because it has tendencies to direct its income to intangible luxuries which are temporary in enjoyment, is made to save through the payment of instalments. His monthly payments in fact represent an alternative form of savings. The sound use of consumer credit may be conducive to more careful planning of family expenditure. It is probably correct that if the life of the goods purchased on credit is longer than the period of payment, real saving takes place.

There are others who believe that instalment buying is not conducive to saving. The high pressure salesmen cause people to buy on credit articles of luxury which are quickly consumed. They could not have bought these if they were required to pay cash. The buyer soon acquires the luxury habit by being able to possess these articles, which leads to spending and consuming rather than saving.

W.C. Plummer appraising these viewpoints, states

> The difficulty of this question is in the fact that the same kind of instalment buying seems to affect different people differently. It is undoubtedly true that instalment buying causes some individuals to plan their expenditures and thereby leads to saving. But it is equally true that other individuals are lead into extravagant spending by exactly the same set of circumstances.[4]

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[4]Wilbur C. Plummer, Op.Cit., p. 57.

Large production in the present century is the result of large savings. Along with large production there has been consistently large consumption. More and more durable goods have all along been added to the household. In the United States the statistics show that a spending unit has experienced considerable increase in its net worth.

> Federal Reserve estimates placed the total assets of the 54 million spending units in this country at more than $725 billion early in 1953. After deducting debts of $85 billion, this left a net worth of over $64 billion, or an average of 12,000 per spending unit. And these estimates do not include the value of cash, insurance policies, trust funds and pensions, furniture or clothing.[5]

In Canada 78% of all spending units in 1956 had incomes below $5,000 per a year and 71% of indebted units had incomes in this range.[6] In this income range, very little would be left after necessary day to day expenditure, payment of taxes and some provision for the "rainy day" has been allowed for. Whatever is left is more likely to be spent on something of immediate use than to be set aside as savings until enough is accumulated to pay cash for a major item of durable goods. If planning is done wisely, moderate instalment payments can be fitted into the family budget and

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[5]Ernst A. Daner, The Role of Consumer - and of consumer credit - in our economy (mimeographed) 1958, p. 9.

[6]Wm. C. Hoad, Financing of Economic Activity in Canada, Royal Commission on Canada's Economic Prospects, 1958, p. 151.

immediate benefits enjoyed.

Consumer behaviour is very difficult to analyse. Various approaches to this problem have been made by the economists. Any discussion of consumption theory is beyond the scope of this study. The existence of credit depends upon the existence of "discretionary income". If there is no "discretionary income", all must be spent to keep people alive. Such a condition means poverty. When the community gets beyond the level of poverty, the element of savings appears, and that is what the economists call "real savings". A theory of saving is a part of the general theory of consumption. Consumers are not affected directly by the saving action of others because they do not know about their savings, but indirectly they are affected. Duesenberry believes that lower income families will not be influenced by any attraction to save because their desires for current consumption are strong enough to overcome any future considerations. The upper income group people will therefore do most of the savings. His general conclusions are that there is no correlation between the aggregate saving ratio and the absolute aggregate income, rather, the former is dependent upon interest rates, the relation between current and expected future incomes, the distribution of income, the age distribution of population, and the rate of growth of income.[7]

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[7]James S. Duesenberry, Income Saving and Theory of Consumer Behaviour, Harvard University Press, 1949, p. 45.

Some other economists have tended to agree with him.

Carl A. Dauten, after appraising various approaches to the consumption theory, has derived a kind of credit theory. He divides credit into emergency credit, convenience credit and instalment credit to buy durable goods. He disposes of the first two categories quickly by saying:

> Emergency credit is not part of any pattern of consumer behaviour, but a safety valve for use in emergencies. It behaves counter-cyclically and probably becomes less important in relationship to aggregate real income as income rises. Convenience credit moves with disposable income, but shows a rising trend. This is due to the greater acceptance of such credit by consumers and the expansion of its use by merchants.[8]

Dauten thinks that the third category,that is,instalment credit,presents the basic problem. The level of such credit depends on the sale of durables, and further, the proportion of durables bought on an instalment basis. The factors that influence sale of durables are discretionary income, expectations of future income, the pattern of distribution of income amongst spending units, and the growth of income.

Dauten's theoretical views may be summarized as follows:

> 1. The level of consumer debt is independent of the absolute level of income.

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[8]Carl A. Dauten, "A Fresh Approach to the Place of Consumer Credit in Economic and Financial Thinking", _The Journal of Finance_, Vol IX, No. 2 (May 1954), p. 120.

2. It is based on the demand for durable goods which is based on discretionary income, the rate of change in such income, expected income, the pattern of income distribution, the age distribution of the population, the stocks of durables on hand and similar factors.

3. The proportions of durables bought on credit are based on the income status of the spending unit, the family status, holdings of liquid assets and the level of other debts.

4. Also significant are the size of the down payment, the size of the instalments and credit charges.

5. Because of the large amounts involved in most purchases of durable goods in relation to credit costs, the use of credit will be rather insensitive to changes in credit costs.

6. The propensity to use credit rises as income rises, but at upper middle income levels, it stabilizes and then declines. The pattern is likely to change with changes in shape of the income distribution.

7. The use of consumer credit will change during the business cycle in part because both granters and users of credit become more cautious, but primarily because changes in real income shift families into real income groups in which different amounts of credit are used.[9]

This is a very recent theory which will have to stand the test of time before it can be accepted. However, it is highly suggestive, and can give an insight into the broad field of institutionalised consumer financing. One should

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[9]Carl A. Dauten, op. cit., pp. 122-123.

not try too hard to apply this to the practical problems faced by the credit unions.

Nevertheless, in order to retain their competitive position in consumer financing, the credit unions have to base their operations upon an understanding of consumer motivation in saving and dissaving.

II. MOTIVATION OF A CREDIT UNION MEMBER TO SAVE

We know very little about what motivates a credit union member to save, and then to put his savings in a credit union instead of in some other financial agency. Common bond is undoubtedly one of the factors that influences a member, but the extent of its influence is debatable. The credit unions in Canada need much basic research in this field. Since there is no empirical data available, all that we can do is to draw analogies from studies made in the consumer field in general. In 1953, the United States Savings and Loan League[10] conducted a survey on various aspects of savings and loan associations and banks. One of its findings was that the economic characteristics of people who saved in banks were not much different from those of people who saved through Building and Loan Associations. So it is not unreasonable to draw an analogy that a saver in a credit

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[10]United States Savings and Loan League, Consumers Survey on Savings Habits (Washington: U.S. Savings and Loan League 1954).

union is motivated by almost the same factors as those that motivated a saver in a bank, or in a saving and loan association. The study also found that the main purposes of savings were to provide for emergencies, future family expenditures and old age. Only a small percentage of people regarded the savings as investments for added income. This agrees with Baron's[11] argument that the main reason for saving amongst the working class was deferred expenditure, and not for deriving income from permanent investments. Since more than two-thirds of the business of credit unions is derived from manual workers,[12] we find that deferred expenditure is the most prominent reason for credit union members to save.

As far as the place of saving is concerned, the American survey indicated that safety and convenience ranked highest amongst all the factors in making the choice. The habit of people also plays an important part in continued preference for one institution over another. The rate of earnings paid on savings, while important to a certain degree, did not govern the decisions of most of the savers.

III. PLACE OF CREDIT UNIONS IN CONSUMER LENDING IN CANADA

There are quite a number of agencies which are con-

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[11] N. Baron, Cooperative Banking (London: P.S. King and Son, 1932), p. 25.

[12] E.R. Isbell, Credit Unions and the Recession, Ohio Credit Union League, 1959, p. 53.

cerned with consumer loans such as remedial loan societies, pawn brokers, friends and relatives. Apart from these, there are four leading institutions in this field: namely, chartered banks, instalment finance companies, consumer finance companies and credit unions. Consumer finance companies are called by many names--personal finance companies, small loan companies, money lenders, licensed lenders, and regulated lenders.

Credit unions have grown to the point where they play an important role in the Canadian economy. The following table will show that credit unions rank fourth in instalment credit. There is more than a proportionate growth trend in credit unions as compared with other financial institutions. The small loan companies have shown a declining trend in 1957 and 1958. This is partly due to the recession in that period and probably the 1956 amendment to the Small Loan Act 1939 which reduced the rate of interest a company can charge. It is interesting to note that when unemployment rose in 1957 and 1958, the percentage increase in instalment credit in credit unions was more than in any other institution. This shows that credit unions have a stabilizing effect on the economy. They continued to serve their members even when the plants were closed for a long time; the reason appears to be that the credit unions are fully conscious of the difficulties of the members, and try to help them in good as well as bad times. This is the cooperative spirit. We will consider in the latter part of this study whether or not this cooperation was overdone to affect the liquidity of credit unions in British Columbia. It is evident from Table 1 that if the credit unions keep up the trend which they have shown, they will acquire the third position in volume of credit in all these lending institutions.

The percentage distribution of instalment loans by holders in Canada in 1959 was:

Instalment Finance Companies	27.4%
Chartered Banks	24.9%
Retail Dealers	18.2%
Small Loan Companies	16.6%
Credit Unions	12.4%
Quebec Savings Banks	.5%
	100%

In the United States of America, Credit Unions held 8.1% of total instalment loans.[13]

The consumer loan can be broken down into two categories: first, the loan granted for the purchase of consumer goods like household equipment and automobiles; and second, the loan granted for medical expenses, education, payment of taxes, consolidation of debts, vacation expenses and similar other purposes. The latter category of loans is called personal loans. There is no data available regarding

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[13] Credit Union Year Book 1960, Credit Union National Association, Madison, Wisconsin, U.S.A., p. 19.

TABLE I

INSTALMENT CREDIT IN CANADA
(In Millions of Dollars)

YEAR	Instalment Finance Companies	Percentage Increase from Previous Year	Small Loan Companies Instalment Credit & Cash Loans	Percentage Increase from Previous Year	Department Store Conditional Sale Agreements	Percentage Increase from Previous Year	Other Retail Dealers Instalment Credit	Percentage Increase from Previous Year	Chartered Banks Selected Personal Loans	Percentage Increase from Previous Year	Quebec Savings Banks Loans Not Secured by Mortgages	Percentage Increase from Previous Year	Credit Union Loans Not Secured by Mortgages	Percentage increase from previous year
1958	$768	-1.54	$401	10.75	$224*	17.17	$266	-1.85	$553	23.8	$12	-7.7	$313	21.3
1957	780	3.18	362	1.69	209*	29.8	271	9.26	421	3.32	13	18.2	258	14.15
1956	756	25.1	356	27.6	161	9.5	248	7.83	435	-1.36	11	37.5	226	29.9
1955	599	21.8	279	29.8	147	26.8	230	11.6	441	25.3	8	14.3	174	15.2
1954	492	-4.7	215	22.2	116	14.86	206	12.6	352	14.3	7	-12.5	151	17.1
1953	516	38.4	176	18.9	101	26.2	183	12.3	308	27.2	8	33.3	129	37.2
1952	373	100	148	29.8	80	196.2	163	69.8	242		6		94	
1951	186		114		27		96							

*Includes other Deferred Payment Plans.

Source: Bank of Canada and Credit Union Year Book 1960, Credit Union National Association, Madison, Wisconsin, U. S. A.

the volume of personal loans granted by each financial institution in Canada. According to E.R. Isbell, there is the greatest competition between consumer finance companies, banks and credit unions in this category of loans. In the United States

> The commercial bank is doing about 45% of their consumer loan business in this area; the credit union 60%, and the personal finance company 75%. ....If the credit union is to make significant progress in its competition with the other two agencies, it would seem that it should be in the area of the personal loan.[14]

Apart from consumer credit, the credit unions are also a source of credit to small business. If the proprietor of a business is a member of a credit union, he can borrow at an interest rate of usually 8% on the unpaid balance. Such loan is generally secured by a mortgage on buildings and equipment and is normally for a term of less than five years.[15] The writer investigated the practices of British Columbia Credit Unions regarding credit in small business. It was found that very little lending is done to small business and the rate of interest charged is usually between 9 and 11 per cent.

The credit unions also do a fair amount of mortgage

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[14]E.R. Isbell, Credit Unions--and the Recession, 1959, Ohio Credit Union League, p. 51.

[15]Small Business Manual, Department of Trade and Commerce, Ottawa, Queen's Printer, Third Edition, 1959, p. 82.

lending. An upward trend in real estate loans is seen as the credit unions grow in size. This type of lending will be discussed in detail in the latter part of this study.

A credit union is a lending as well as a savings institution. The savings part of it is more important because savings provide the major portion of funds for lending. Table No. 2 shows that credit unions act as depositories for a significant portion of total net savings in Canada. The trend is continuing upward. Between 1945 and 1958, the net rise in individual savings held by credit unions was about 676%. For Table II see p. 17.

In 1959, credit unions in Canada held 11.4% of the total personal savings whereas chartered banks, trust and loan companies, and 'Other banks' held 67.8%, 16.3% and 4.5% respectively. It is interesting to note that credit unions in the United States had only 2.83% of the total personal savings. This shows that a credit union is better accepted as a saving institution in Canada.[16]

IV. COOPERATIVE CENTRAL BANKING IN CANADA

As the credit union movement became fairly strong in Canada, Province-wide cooperative credit societies, or central credit unions were formed to function as desposit-

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[16] Credit Union Year Book, 1960; Credit Union National Association, Madison, Wisconsin, P. 18.

TABLE II

CREDIT UNION SAVINGS AS PERCENTAGE OF TOTAL NET SAVINGS IN CANADA

(Amounts in Millions of Dollars)

Year	Total Personal Income	Personal Disposable Income	Personal Expenditure on Goods and Services	Total Net Savings	Total Net Savings Excluding Farm Inventory Change	Total Savings in Credit Unions	Net Increase in Credit Union Savings over Previous Year	Credit Union Savings as a % of Net Savings Excluding Farm Inventory Change
	$	$	$	$	$	$	$	%
1958	24,391	22,600	21,012	1,588	1,703	933.8	158.9	9.3
1957	23,024	21,107	19,964	1,143	1,295	774.9	74.3	5.7
1956	21,885	20,153	18,833	1,320	1,079	700.6	97.7	9.1
1955	19,783	18,239	17,389	850	652	602.8	92.2	14.1
1954	18,421	16,984	16,175	809	884	510.6	56.9	6.4
1953	18,336	16,904	15,592	1,312	1,226	453.6	27.3	2.2
1952	17,395	16,072	14,781	1,291	960	426.4	92.3	9.6
1951	15,824	14,794	13,460	1,334	985	334.1	45.1	4.6
1950	13,428	12,688	12,026	662	583	288.9	25.1	4.3
1949	12,638	11,849	10,923	926	1,033	263.8	24.5	2.4
1948	11,901	11,079	10,085	994	1,027	239.4	30.5	3.0
1947	10,375	9,584	9,090	494	548	208.9	30.2	5.5
1946	9,719	8,923	8,031	892	878	178.7	39.6	4.5
1945	9,120	8,311	6,969	1,342	1,581	139.1		

Source: Credit Union Year Book 1960, Credit Union National Association, Madison, Wisconsin, U. S. A.

ories for the surplus funds of the credit unions and other corporations who in turn could obtain borrowings from them. In the Province of Quebec, however, the set-up is different. There is one central credit union under the Quebec Credit Union League which deals only with member credit unions of the league all over the Province. A large percentage of credit unions in Quebec are not members of the league. There are ten regional Caisses Populaires but they are not federated into one provincial cooperative credit society. The amount of business done by the provincial central credit unions and their growth from 1954 to 1958 is given in Table No. III. For Table III see p. 19.

Table No. III displays the strength of the credit union movement in Canada. The utilization of central banking is becoming more and more popular amongst credit unions. The assets in 1958 almost doubled the amount in 1954.

As the provincial central credit unions prospered in Canada, a need was felt that a national cooperative credit society should be formed to act as an apex institution for the whole of Canada. After a prolonged effort by the Canadian Cooperative Union, the Canadian Cooperative Credit Associations Act was passed.[17] This was an enabling

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[17]Cooperative Credit Associations Act Sc. 53, c. 28.

TABLE III

STATISTICAL SUMMARY--PROVINCIAL CENTRAL CREDIT UNIONS

Year	Members: Credit Unions	Members: Co-ops	Total Assets	Loans and Mortgages Outstanding	Investments	Shares	Deposits	Loans Granted in the Year
	Number		$000's	$000's	$000's	$000's	$000's	$000's
1958	4,265	711	$126,238	$26,276	67,924	20,554	92,642	45,632
1957	3,912	694	103,122	22,016	54,177	17,092	76,025	46,512
1956	3,913	611	87,551	21,710	50,295	14,271	65,856	45,802
1955	3,663	540	77,458	15,569	46,880	11,754	61,323	27,832
1954	3,302	487	64,531	14,597	39,191	9,664	46,225	23,066

Source: Credit Unions in Canada, Marketing Service Economics Division, Canada Department of Agriculture 1954 to 1958.

legislation only. Consequently a special Act had to be secured to incorporate an association under this Act. In the same year "an Act to incorporate Canadian Cooperative Credit Society Ltd.,"[18] was passed. This Act allowed the organization of the Canadian Cooperative Credit Society.

The Canadian Cooperative Credit Society serves as a central savings and credit organization at the National level for credit unions and cooperative movements in Canada. Its financial position as on December 31, 1958, was:

> Total assets of the Canadian Cooperative Credit Society as of December 31, 1958, amounted to $104,185. Member societies subscribed 2,656 shares of a total value of $265,000 of which $108,900 was paid up. The Canadian Cooperative Credit Society made its first loans in 1957. In that year loans of $400,000 were made to members.[19]

The total membership at the end of 1959 was nine. Its purpose is to serve as a depository for surplus funds of member associations and provide them with borrowings. To conduct its operations it may have to borrow money from its members or the chartered banks. According to the Canadian Cooperative Association's Act the borrowings of the Association plus the deposits plus the amount of repayments, if any, of its members guaranteed by the Association should not exceed ten

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[18]"An Act to incorporate Canadian Cooperative Credit Society Ltd.,", s.c. 53, c.58.

[19]Credit Unions in Canada, Marketing Service, Economic Division, Canada Department of Agriculture, 1958, p. 19.

times the aggregate of the paid up capital, guarantee fund and the surplus. An association cannot make any loan or any investment in funds other than government,municipal or school securities if the aggregate of its cash on hand or in the bank and the market value of existing government, municipal or school securities is less than twenty per cent of the total amount on deposit with the association, or if such lending or investment would reduce it to less than twenty per cent. Further an association under the Act must keep at least five per cent of the total amount of money on deposit with it in cash or on deposit in a chartered bank at all times.

The Superintendent of Insurance, Federal Department of Insurance has been empowered to carry out inspections of the affairs of an association and is responsible to report to the Minister of Finance annually as to its financial position.

The other main restrictions on the association are that it cannot lend money to natural persons, or to any cooperative credit society which does not hold a valid certificate issued by the Treasury Board, nor on the security of mortgage on real property. Before issuing the certificate, the Board satisfies itself as to the society's compliance with the provisions of the Act and the financial condition of the applicant. The total amount of loans plus the amount invested in the securities of any one member of an association should not exceed ten per cent of the total of the paid up capital and deposits of the association, unless the excess is secured by government, municipal or school bonds.

An association under the Act must set aside twenty per cent of net annual earnings to be set up as a guarantee fund to be used against contingencies, losses, and uncollectable loans. The setting aside may be stopped when the total reserve is equal to ten per cent of the paid up capital. It can pay interest at a rate not exceeding five per cent per annum on the paid up capital, and the rest of the earnings must be distributed in dividend. The authorized share capital of the National Association is one million dollars with 10,000 shares of $100 par value each.

The membership of the Canadian Cooperative Credit Association has been restricted to the following: cooperative credit societies incorporated by a special act of Parliament; cooperative credit societies declared eligible by Parliament through registration; a maximum of ten cooperative corporations (not being cooperative credit societies) carrying on business in two or more provinces; and a maximum of fifteen natural persons. An association cannot be a member of any of its incorporated members.

V. REGULATION OF ACTIVITIES OF B.C. CENTRAL CREDIT UNION

The B.C. Central Credit Union was organized in May, 1944, under the B.C. Credit Union Act after special amendments had been made in the Act to allow such organization. In 1955, the B.C. Central Credit Union received added powers when it obtained the certificate of the Treasury Board under the Canadian Cooperative Credit Associations Act. On account of the B.C. Central's registration under this Act, its affairs automatically come under the supervision of the Federal Department of Insurance. The B.C. Central Credit Union is governed by two Statutes, the Canadian Cooperative Credit Associations Act, and the British Columbia Credit Union Act. Section 79 of the former Act provides:

> Every organization that
> (a) is carrying on the business of a cooperative credit society
> (b) is declared by Parliament to be eligible to become a member of an association, and
> (c) is registered on the books of the association as a shareholder thereof shall for the purposes of Part II and III be deemed to be a cooperative credit society incorporated by special Act and except as provided in this Part, every such organization is invested with all the powers, privileges and immunities conferred on association by sections 6, 8, 10 and is subject to the limitations, liabilities and provisions set forth in Parts II and III and in this Part.[20]

The Parts II and III mentioned in the section deal with limitations, restrictions, audit, supervision and liabilities. Sections 6, 8 and 10 deal with objects, powers, and purchase or sale of business. The Provincial Statute has

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[20] Cooperative Credit Associations Act, S.C. 1952/53, c. 28. s. 79.

allowed the Cooperative Credit Associations Act the superceding power over "central" in case the provisions of the former are inconsistent or repugnant to the provisions of the latter. Section 74 of the B.C. Credit Union Act provides:

> Notwithstanding the other provisions of this Act, a central credit union which, in compliance with sec. 8, has become member of an association within the meaning of the "Cooperative Credit Associations Act" being chapter 28 of the Statute of Canada 1953, shall have the power and capacity to accept all powers, privileges and immunities conferred upon it by the said "Cooperative Credit Association Act"; and, during such time as such central credit union is invested with powers, privileges and immunities under the "Cooperative Credit Associations Act" any restrictions, regulations or limitations imposed upon such central credit union or its powers by this Act which are inconsistent with or repugnant to the provisions of the said "Cooperative Credit Associations Act" shall not apply to such central credit union, save and except sections 42, 43 and 44 of this Act, which shall continue to apply.[21]

Sections 42, 43 and 44 relate to inspection by the Inspector's Department of the B.C. Government.

The Canadian Act requires that all "centrals" must make an allowance for the full difference between the book and market value of all the investments on hand. The book amount of loans receivable must be reduced by the percentage allowance determined in relation to the length of an existing default in repayment of an instalment. These percentages in relation to the length of the default are

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[21]Credit Unions Act, R.S. 1948, chapter 82, British Columbia, s. 74.

stipulated in the Act. These regulations ensure the security and liquidity of central credit unions. After these requirements have been taken care of, interest payment on paid up capital could be made or dividends declared.

An investment in the capital of central is required from all members. This is based on their own size, and does not exceed two per cent of the paid up share capital of any member credit union. Since credit unions are required to carry liquidity reserves, and these may be in term deposits, the B.C. Central Credit Union in 1949 set up a Term Deposit account.

A comprehensive treatment of the affairs of the B.C. Central Credit Union will be given in Chapter II.

CHAPTER II

FINANCIAL SOUNDNESS

In chapter I the place of credit unions in the Canadian economy was discussed. In this chapter, an evaluation will be made of the financial soundness of credit unions in British Columbia.

There are three main factors determining the financial soundness of a credit union: adequacy of reserves, liquidity, and growth. In this study each factor will be taken separately to assess the situation in British Columbia.

A credit union may have large reserves but no liquidity or vice versa. The reserves are required to keep members' shares intact. In times of economic distress, if adequate reserves are not available, the shareholders' equity might be impaired. On the other hand, if adequate reserves have been provided for, but there is not enough ready money to pay for the withdrawals of shares or other demands for cash, there would be a forced sale of assets which might more than offset the reserves. Both reserves and liquidity are important in their own places. Reserves are the amounts of net earnings set aside to absorb future losses, and the degree of liquidity indicates the ability of the credit union to meet normal demands for money.

There are various aspects of the problem of reserves--legal, moral and economic. The legal aspect can be disposed of briefly because the law on the point is clear, and all the credit unions have to abide by it. The economic and moral considerations will be discussed wherever necessary in this chapter.

I. CREDIT UNION RESERVES

A large variety of reserves has been developed for banks, personal loan companies and other similar financial institutions. They are not necessarily suitable for credit unions. Credit union reserves may be classified into two basic groups.

1. Valuation Reserves
    - (a) Accumulated Depreciation. This is created by charges to income for the loss in economic utility of fixed assets--equipment, furniture, buildings, etc.
    - (b) Allowance for bad debts. Generally in other operations, this allowance is created by charges to income to represent the expected loss from uncollectable accounts. In most businesses this account has "tax allowance" treatment, and proper valuation of the account has to be made every year. The theory behind it is that charges for the loss in receivables should be made in the period when the receivable was acquired. In credit unions, the method is different; a set percentage of the annual net income is set aside regardless of the amount of bad debts.

The reason for this treatment could be first that the credit union income is tax free; and second, that it is easy to calculate, which agrees with the fact that credit union management may not in some cases be qualified to understand accounting techniques.

2. <u>General Capital Reserves</u>

(a) Retained Earnings. Since the credit union share capital is unlimited and the shares cannot appreciate in value regardless of the amount in "retained earnings" or other increase in equity, the undistributed income really becomes an addition to capital, or in other words, an unallocated capital reserve. Morally, all net income of a credit union should be distributed in dividends; otherwise future shareholders will have the benefit of this retained money at the expense of the existing shareholders.

(b) Reserve for contingencies. A contingency is a possibility conditional on something uncertain, a happening from unforeseen causes subject to unforeseen conditions. Such reserves are generally established when there is a pending law suit, or some future possible losses which have not been provided for. They are properly part of the retained earnings and should be returned to it when no longer required.

3. <u>Secret Reserves</u>

This results from the practice of handling interest income by credit unions. The B.C. Credit Union Survey Report indicates that only twenty-one out of three hundred and twenty-six credit unions accrue interest income in their books, and the rest account for it on a cash basis. Going further, the Survey analysed the situation by the following calculations:

Total loan interest recorded in 1958	$4,396,893
Total interest income of those adopting accrued interest	997,593
Balance-interest of those operating on cash basis	$3,399,300

> If one were to assume that the due dates of loan payments were equally distributed throughout the month, and that all repayments were made on such due dates, then on the average basis there would always be one half month's interest accrued but not yet due on any given date. This would suggest a very conservative estimate of an accrued figure of 5 per cent, or $170,000, at 31st December 1958.[1]

For the purposes of this study, statutory reserve fund will be analysed separately, and other reserves lumped together and shown in the tables under the caption "Other Reserves".

The B.C. Credit Unions Act requires that:

> At the end of each fiscal year there shall be set aside twenty per centum of the net earnings for the year, or such further amount as may be authorized at the annual meeting, as a reserve fund until that fund is equal to twenty per centum of the share capital paid up at the end of the year.

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[1] B.C. Credit Union League, Survey Report June 1960, Vancouver (mimeographed), p. 53.

> The reserve fund shall be used only for paying losses of the credit union arising from bad loans or investments....[2]

The latter part of this section is a fallacy. When a loss on bad loans or investments occurs, no payment shall be made by the credit union. The payment was made when the loan was granted or the investment made. In case of loss, there will be no further payment of money; only a part of payment already made will not be recovered. The writer feels that the legislators, in formulation of the above section, confused the reserve for bad debts with liquidity of a credit union.

The term "reserve" has been used so much in accounting terminology in various senses, that it is better to drop its usage. More especially for credit unions, it would be desireable to replace this term with some other suitable words.

A possible hardship to the credit unions, caused by the "reserve" for bad debts and loss on investments as required by the statute, will be touched on in the latter part of this chapter. How the percentages stipulated in sec. 34 of the B.C. Credit Union Act were decided is not readily ascertainable. The most probable answer would be that they were borrowed from similar statutes of other places. If so

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[2]Credit Unions Act, R.S. 1948, c. 82, s. 34, ssl and 3.

the question arises as to whether the percentages stated in the original statute were derived as a result of experience, or just as of rule of thumb. Dr. John T. Croteau, reviewing a similar piece of legislation, stated:

> How the original 20 per cent and the 10 per cent maximum were arrived at rests in the dim pages of history; one thing sure is that they were not derived from experience, since credit union legislation was passed prior to the organization of these institutions. Probably the original reserve requirements were set by a generous application of a rule of thumb.[3]

In the light of this statement, credit unions would find it useful to study the adequacy of this provision.

There is a considerable difference between a bad loan and a delinquent loan. According to the B.C. Credit Union Act, a loan is deemed to be delinquent where any amount of principal or interest is in arrears for more than three months. A bad loan, according to the general connotation of the word, is a loan that is uncollectible. By sec. 24(7) of the same Statute, a credit union has a statutory lien on the shares and deposits of a member for a debt due or owing from him. If an instalment is overdue for a period of three months or more from a borrower who has taken a loan for two hundred dollars, and who has five hundred dollars in shares of the credit union, his loan according to the Act becomes

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[3]John T. Croteau, Management Reviews Reserves, National Credit Union Management Conference, Los Angeles, California, October 6-9, 1957 (mimeographed), p. 1.

delinquent. The credit union, however, has the power to offset the delinquent loan against the member's equity. Hence such a loan cannot become a loss. If in any year the amount of delinquent loans exceeds 10% of the loans outstanding, no dividend can be paid out unless the Inspector of Credit Unions allows it.[4] The degree of delinquency, though not a good yardstick to measure the financial soundness of a credit union, does reflect on its managerial efficiency.

In the Survey conducted in 1959 by the B.C. Credit Union League to determine the uncollectible loans situation, a stratified sample by sizes of credit union was taken. The delinquent loans were analysed in light of the existing circumstance. For example, such questions as these were asked: when was the last payment received; what amount was paid during the preceding six months; what security was taken; what was the value of the security, etc. The results obtained are given in Table IV.

For Table IV see p. 33.

In Table 4 the figures given under the columns, "Total Loans Outstanding" and "Amounts of Loans Granted Since Incorporation" are exclusive of the endowment loans. The percentages calculated do not show a regular pattern. 1.05% of

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[4]Credit Unions Act, R.S.1948, c. 82, s. 34 ss 2(d).

TABLE IV

PERCENTAGE OF ESTIMATED BAD LOANS ON BOOKS TO TOTAL LOANS OUTSTANDING AND BAD LOANS ON BOOKS PLUS LOANS WRITTEN OFF SINCE INCORPORATION TO TOTAL AMOUNT OF LOANS SINCE INCORPORATION

Size of Credit Union Assets	Number in the sample	Total Loans Outstanding	Estimated amount of bad loans	% bad loans on books of total loans outstanding	Amount of bad loans written off since incorporation	Total bad loans on books & written off since incorporation	Amount of loans granted since incorporation	Percentage bad loans since incorporation of total leans since incorporation
($000)								
Up to 25	14	109,526	2,753	2.51	400	3,153	540,445	.583
25 - 50	9	275,641	3,560	1.29	649	4,209	1,366,818	.323
50 - 100	15	904,594	13,728	1.50	4,816	18,544	4,525,248	.410
100 - 250	16	1,630,642	21,507	1.30	8,100	29,607	8,046,898	.368
250 - 500	10	2,415,047	38,868	1.60	23,456	62,324	11,243,357	.554
500 -1000	7	3,290,736	36,892	1.12	13,304	50,196	15,589,908	.322
1000-2000	7	6,650,910	74,529	1.12	50,192	124,721	30,671,499	.407
Over 2000	4	8,542,850	59,929	.70	40,180	100,109	30,798,860	.325
	82	23,819,946	251,766	1.05	141,097	392,863	102,783,033	.382

Source: B.C. Credit Union League, Survey Report, June, 1960, (mimeographed) Vancouver, p. 52, and Files of Inspector of Credit Unions British Columbia.

the outstanding loans have been estimated to be bad. The percentage of total bad debts since incorporation to total loans since incorporation is .382. This indicates two things: either the credit unions have no regular policy for writing off the loans, or the estimation of the bad debts on the books has been too large. The former seems to be the more probable. It would not be out of place to remark that the low loss ratio is not necessarily a measure of good management. A low ratio might be secured by following an unreasonably conservative lending policy, which may mean losing some profitable business or adopting an excessively stringent collection attitude. These practices, though financially sound, are against the credit union philosophy.

There is no data available regarding the bad debt experience of banks and consumer finance companies on personal loans. None of them wishes to divulge any information about personal loans.

It is quite interesting to note that in the B.C. Credit Unions Act, the adequacy of a bad debt reserve has been related to the outstanding share capital. Sec. 34 states:

> At the end of each fiscal year there shall be set aside twenty per centum of the net earnings for the year, or such further amount as may be authorized at the annual meeting as a reserve fund until that fund is equal to twenty per centum of the share capital paid up at the end of the year.[5]

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[5] Credit Unions Act, R.S. 1948, c. 82, s. 34.

In mercantile corporations, the reserve for bad debts is generally related to loans outstanding. This is more realistic because the creation of this reserve is primarily to absorb the losses occurring from loans outstanding.

In credit unions, however, relating reserve funds to share capital may be quite logical and meaningful because the amount of loans outstanding and share capital keep more or less a constant relative pattern. This is shown in Table V. Apart from this, the purpose of the credit union reserve fund is not only to absorb losses on loans but also to absorb losses on investment funds. Table V presents a comprehensive picture of total share capital, loans outstanding, percentage of reserve fund to loans outstanding and percentage of all reserves to loans outstanding. The credit unions have been divided into eight groupings according to amount of assets. The overall percentage of reserve fund to loans outstanding is 3.4% and the percentage of all reserves to loans is 3.82. It is interesting to note that the latter percentage shows a declining trend with the rise in size of credit union groupings.

II. GROWTH OF CREDIT UNIONS

The growth of credit unions in British Columbia can be measured by the annual increase in savings, membership, and loans. For analysis of the time series regarding savings, membership and loans, the Gompertz curve has been used which

TABLE V

SCHEDULE OF SHARE AND LOAN BALANCES (EXCLUDING ENDOWMENT LOANS) AND OF THE BAD DEBT RESERVE AND OTHER RESERVES AS AT 31 DECEMBER, 1958 ARRANGED IN GROUPINGS OF CREDIT UNIONS ACCORDING TO AMOUNT OF ASSETS

Size of Credit Union Assets (Thousand Dollars)	Total Shares	Total Loans Outstanding	Reserve Fund	Percentage Reserve Fund of Loans Outstanding	Other Reserves	Percentage All Reserves of Loans Outstanding
Up to 25	456,233	442,918	14,569	3.29	3,685	4.12
25-50	1,080,195	1,084,928	44,620	4.11	6,709	4.73
50-100	2,388,705	2,437,867	101,404	4.16	19,142	4.94
100-250	5,614,497	6,015,768	237,766	3.95	24,525	4.36
250-500	7,646,495	8,097,803	298,529	3.69	20,420	3.94
500-1,000	10,816,627	11,483,108	476,740	3.50	30,676	3.73
1,000-2,000	12,457,882	13,610,191	476,740	3.50	30,676	3.73
Over 2,000	10,264,272	11,414,117	346,355	3.01	53,781	3.51
Total	50,744,906	54,586,700	1,909,301	3.496	185,719	3.82

Source: B.C. Credit Union League, Survey Report, June 1960 (mimeographed) Vancouver, p. 54.

describes the growth of a series at a decreasing rate. Table VI shows that the annual increase in the three factors of growth is at a declining rate. The series has been projected up to 1967, and is presented in graphical form in Chart A. The question may be asked as to whether a nine-years series is long enough to establish a trend. The period seems to the writer to be long enough. However, even if it is not, it is doubtful whether the data regarding the abnormal period of the late forties would have contributed to greater perfection of the long term trend. It is interesting to note that the growth in the B.C. credit unions has been due more to an increase in savings than to the addition of new members. As seen from Table VI, there is almost a perfect fit of the Gompertz curve and the actual figures from 1951 to 1959. Some bias is introduced, however, by inclusion in the figures of loans and shares, the amounts of endowment loans and endowment shares respectively. These amounts had to be included because the figures of loans exclusive of endowment loans and of shares exclusive of endowment shares were not available.

Raymond D. Prescott[6] developed a law of growth of an industry. Though a credit union, which is based on no profit motive, is not like an industry in the usual sense, it is

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[6]"Law of Growth in Forecasting Demand" by Raymond D. Prescott, Journal of the American Statistical Association, Vol. XVIII, December 1922, pp. 471-79; and Croxton and Cowden, Applied General Statistics, New York, Prentice Hall, Inc., 1952.

TABLE VI

GROWTH IN MEMBERS, SAVINGS AND LOANS - ALL CREDIT UNIONS
ACTUAL 1951 TO 1959 AND GOMPERTZ CURVE 1951 TO 1967

Year	Members		Savings (Thousands)		Loans (Thousands)	
	Total	Gompertz Curve	Total	Gompertz Curve	Total	Gompertz Curve
1951	61,863	59,480	15,033	15,340	13,092	13,390
52	74,174	74,570	20,055	20,004	17,780	17,160
53	87,347	90,480	25,333	25,340	22,365	21,750
54	110,000	107,500	32,154	31,910	28,344	27,640
55	125,425	124,900	39,949	39,710	34,736	34,790
56	140,339	143,200	47,711	47,730	43,688	43,200
57	161,596	161,000	54,885	55,430	54,041	53,640
58	180,434	178,400	74,557	72,240	64,207	66,000
59	193,663	195,300	89,469	85,860	81,033	80,070
60		214,100		102,300		95,830
61		226,500		120,400		114,200
62		240,700		139,900		134,500
63		253,900		161,000		159,400
64		265,900		186,900		188,100
65		277,100		211,700		217,500
66		287,100		241,400		253,200
67		296,400		268,400		290,000

Gompertz curve: Trend $Yc = Ka^{b^x}$ Origin 1951, x units, 1 year

Source: Files, Credit Union Office, Inspector of Credit Unions, British Columbia and B.C. Credit Union League, Credit Union Survey, June 1960, (mimeographed).

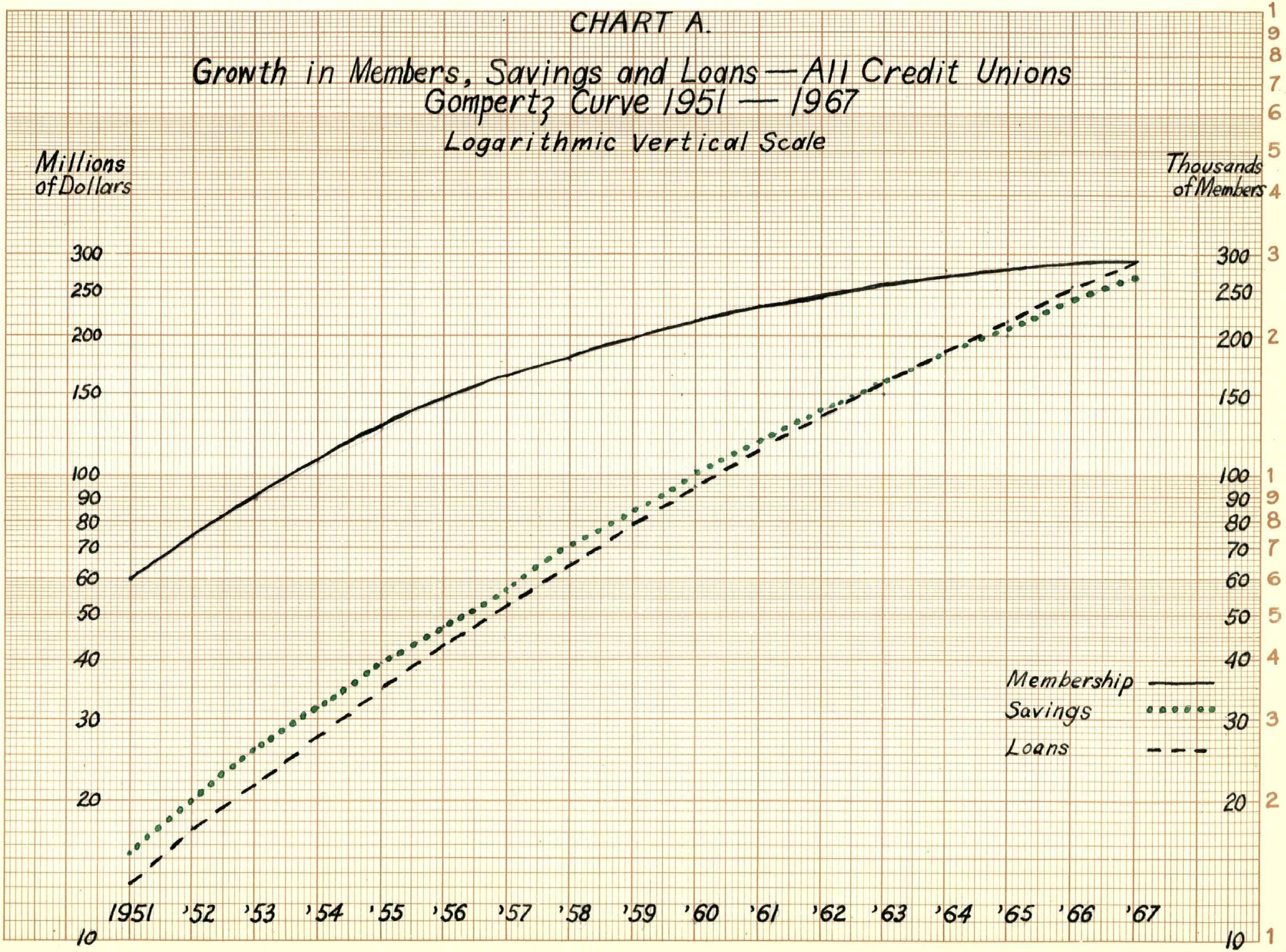
CHART A.
Growth in Members, Savings and Loans — All Credit Unions
Gompertz Curve 1951 — 1967
Logarithmic Vertical Scale
Millions of Dollars
Thousands of Members
300
250
200
150
100
90
80
70
60
50
40
30
20
10
Membership
Savings
Loans
1951
'52
'53
'54
'55
'56
'57
'58
'59
'60
'61
'62
'63
'64
'65
'66
'67

felt that this law of growth has an application to credit unions. Prescott divided the growth of an industry into four stages: first, the period of experimentation; second, the period of growth into the social fabric; third, through the point where growth increases but at a diminishing rate; and fourth, the period of stability.

Though these stages have not been specifically demarcated, it is evident from Table VI and Chart A that the B.C. credit unions are passing through the third stage, and the period of stability is yet to come.

III. LIQUIDITY OF CREDIT UNIONS

Kenneth E. Boulding describes the problem of liquidity:

> If uncertainty is undesirable, efforts will be made to escape from it. This may be done by insurance, which is in effect, the replacement of large uncertain losses by small certain losses (the premiums). It may also be done by liquidity. It is almost impossible to understand the asset behaviour of firms without introducing the idea of liquidity as an escape from uncertainty. The form of liquid assets can be changed easily in response to new information.[7]

There is a relationship between growth and liquidity for credit unions. From the statistics for measuring growth, it can be observed that borrowing is increasing at a faster rate than the supply of share capital. If the present trend continues on for some time, liquidity will become a significant problem. The credit unions cannot expect a regular inflow of cash from share capital to take care of withdrawals. Since

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[7]Kenneth E. Boulding, The Skills of the Economist, p. 92.

the war the credit unions have passed through a relatively secure and prosperous economic period. If the economic fluctuations become acute, there will occur a slackening of net savings as well as slower repayments of loans, and the credit unions will have to resort to some external measures to cope with the situation.

The term liquidity has been used in two different senses, liquidity of an asset and liquidity of an enterprise. By liquidity of an asset is meant the possibility of raising cash by selling the asset, or of borrowing money by pledging it as a security for loan. The liquidity of an enterprise means its capacity to meet the cash requirements during the normal course of business. Liquidity of a business is maintained to protect against uncertainties and consequent liquidation or insolvency.

There is a similarity between credit union liquidity and bank liquidity. It is generally recognised that the theory of liquidity in banking practice has undergone changes during the twentieth century. In North America, the "commercial banking theory", which claimed that liquidity could be maintained only by lending on short term commercial papers, had general acceptance in the first part of the century. In practice, however, it never worked that way. The banks were in fact making long term loans under the guise of short term maturities with covenants of perpetual renewal. Around 1920, a new concept "Shiftability" was introduced in the banking field. This meant that the banks would hold in reserve government bonds or other highly liquid assets which would be cashed whenever need be. During the depression of the 1930's, the so-called highly liquid assets declined considerably in value, giving rise to some bank failures. After that in Canada and the United States, history of banking took another turn. It was recognised that the bulk of bank lending was long term, and if the long term commercial papers were good they could be rediscounted at the"central banks." On the other hand, the member banks would keep their cash reserves in the "central banks". The system distributed the liquidity over a broader base. The credit union system in Canada is organized almost on the same lines. There are central credit unions in all the provinces which act as depositories for surplus cash of the credit unions and grant borrowings to the members within the statutory limitations. Besides these there is the Canadian Cooperative Credit Association, the functions of which have been discussed in Chapter I.

The liquidity of a business depends not only on the ability to meet the normal cash requirements, but also on the ready convertibility of its assets into cash to meet the abnormal cash demands caused by the cyclical and seasonal fluctuations in the economy. The demand for borrowings may also arise in the case of a single credit union or a group of credit unions situated in a particular economic region which has experienced adverse times. Since the amount of borrowing a single credit union can undertake is limited under the B.C. Credit Unions Act, some external help must be secured to keep it solvent.

> The total amount at any time outstanding of money so borrowed by a credit union shall not exceed twenty per centum of the value of its assets, exclusive of sums unpaid on its shares and the value of property of the credit union already mortgaged or charged by it.[8]

The B.C. Central Credit Union cannot be of much help in highly abnormal environments because its lending powers are regulated by the above provision. For meeting such contingencies the B.C. Credit Unions Act was amended in 1958,[9] to sanction the formation of the Credit Union Reserve Board. This is a highly useful piece of legislation insuring the security and safety of members' savings. To build up its Reserve Fund, the Board may assess and levy upon all credit unions in the Province any amount up to one-fifth of one per cent of the total of each credit union's share capital and money on deposit with it at the end of the preceding fiscal period. The Fund may be built up to a maximum of one per cent of the total share capital of, and money on deposit with, all credit unions. The limit on the accumulation of the Fund seems to be too restrictive. A Fund of only one per cent of the shares and deposits may be enough in normal times when only a very minor number of credit unions might get into trouble and need assistance. However, if the Province experiences a rather sharp recession, this Fund will be completely inadequate to meet the demands.

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[8] Credit Unions Act, R.S. 1948, c. 82, s. 14, ss. 2.

[9] Statute Law Amendment Act, 1958, c. 12.

Regarding the disposition of the Fund, the Board can make loans, advances, or grants in aid to member credit unions.

> The Board may, in its discretion, make payments from the Fund for the purpose of making loans, advances, or a grant in aid to a credit union that, in the opinion of the Board, is in financial difficulty and requires assistance from the Fund in order to maintain its solvency and to meet claims of its members for withdrawal of their deposits or redemption of their shares.[10]

The applicant credit union has to satisfy the Board that it is about to be wound up or liquidated, and the assistance will either prevent liquidation or hasten repayment to members of one hundred per cent of their deposits and substantially the full amount of their share holdings. In the case of prevention of liquidation, the money paid from the Fund will have to be repaid. The other reason for obtaining assistance is that in which the applicant satisfies the Board that because of the relocation or closure of an industry or occupation on which the majority of the credit union members depended for their livelihood, there is an abnormal demand for withdrawal of deposits or for redemption of shares. In this case, also, the amount borrowed from the Fund will be fully repaid with interest. These are quite restrictive provisions, and it is likely that some credit unions in distress may not be able to receive assistance.

1. <u>Liquidity in relation to maximum profitability</u>

Liquidity is not in itself a goal of the management. Management has to balance the goal of safety against

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[10] <u>Credit Unions Act</u>, R.S. 1948, c. 82, s. 80.

> the goal of profitability and to seek a proper relationship among the items which enter the balance sheet composition.[11]

There are two management objectives to maintain liquidity of the business.

> (1) to provide sufficient cash to meet current and projected operating needs consistent with maximum profitability of operation and (2) to have the ability to retreat to cash without delay in cases of emergency.[12]

In order to meet the first objective, a credit union should have a regular inflow of cash to meet its requirements. A budget of cash flow for share withdrawals and loans should be prepared in the beginning of the year. An older credit union will have enough past experience from which the seasonal pattern of withdrawal of shares and loan demand can be drawn. There could not be any accurate general seasonal pattern for all the credit unions because each credit union is governed by its own environment. In drawing the budget, some of the factors which will determine the cash requirement are:

a) The existing economic conditions;

b) The amount of unused borrowing rights;

c) The credit rating of the credit union;

d) The amount of shares and saving deposits expected;

e) The amount of loan repayments expected;

f) The expected share and deposit withdrawals;

g) The expected demand for loans.

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[11]John T. Croteau, Management Looks Ahead and A Study of Cash Flow, Short and Long Term Investment Ratios, National Credit Union Management Conference, Philadelphia, 1958, p. 21.

[12]John T. Croteau, *op. cit.*, p. 20.

The second management objective can be met only by keeping the assets readily convertible into cash when faced with unexpected demands, or through outside help.

2. Sources of Liquidity

The internal sources of liquidity are:

a) Cash on hand or in bank;

b) Investments in bonds, securities and term deposits with B.C. Central Credit Union, which can be converted into cash with little or no loss of values;

c) Repayments from loans;

d) Receipts from the sale of shares and the deposit savings.

Externally, the funds come in by borrowing from various financial institutions, including the B.C. Central Credit Union. It depends upon good lines of credit.

The size of share accounts has some impact on the liquidity. The larger the size of the share holdings, the more erratic will be the pattern of share withdrawal, and consequently it poses a hazard to liquidity. In some cases, a few large shareholders may force the credit union officials to adopt certain policies which could impair liquidity. A few large loans may be taken out for speculative purposes, the liquidation of which might become difficult, and consequently bring about insolvency of the credit union. However, the credit union can be saved to some extent from this undue control by a few shareholders, if the directors impose the requirement of ninety days' notice for withdrawal of shares. Notwithstanding this authority conferred upon them under Rule 13[13] to require the notice, the writer has come across no case where the directors exercised it. From the management point of view, credit union shares are like ordinary savings deposits.

3. Measurement of Liquidity of Credit Unions

According to the B.C. Credit Unions Act, the following minimum amounts must be kept on hand:[14]

1) twenty-five per cent of saving deposits;

2) five per cent of share capital;

3) total amount of Reserve Fund.

To review whether these requirements are complied with, the B.C. Credit Union Survey examined the 1958 year end financial statements of all the credit unions. Table VII shows that the total funds retained by the credit unions, grouped according to sizes, were larger than the legal requirement. It is quite interesting to note that in bigger credit unions, the percentage excess of funds to requirements is lower than that in smaller sizes. This is probably due to the fact that larger credit unions are more conscious of the overall profitability of the business.

Individually only a few credit unions were short of the requirement, but the amounts involved were negligible.

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[13] Credit Unions Act, R.S. 1948, c. 82, Constitution and Rules, R. 13.

[14] Credit Unions Act, R.S. 1948, c. 82, ss. 13, 24, 34.

TABLE VII

SUMMARY OF THE LEGAL CASH REQUIREMENTS AND OF THE CASH FUNDS HELD AT 31 DECEMBER, 1958 OF ALL CREDIT UNIONS GROUPED ACCORDING TO THE AMOUNTS OF ASSETS

Size of Credit Unions (Thousand Dollars)	Requirements					
	5 per cent of Shares	25 per cent of Deposits	Total	Reserve Fund	Total Funds Required	Total Funds Held
Up to 25	22,812	760	23,572	14,569	38,141	97,896
25 - 50	54,009	1,277	55,286	44,620	99,906	232,496
50 -100	119,435	13,425	132,860	101,409	234,264	494,729
100- 250	280,725	59,431	340,156	237,766	577,922	1,041,015
250 -500	382,325	73,791	456,116	298,529	754,645	1,071,963
500 -1,000	540,831	193,817	734,648	389,313	1,123,966	1,602,277
1,000 -2,000	622,894	200,373	823,272	476,740	1,300,012	1,915,078
Over 2,000	514,214	373,271	887,485	346,355	1,233,840	1,262,397
Totals	2,537,245	916,150	3,453,395	1,909,301	5,362,692	7,717,851

Source: B.C. Credit Union League, Survey Report, June 1960 (mimeographed), Vancouver, p. 59.

In one case, there existed a substantial shortage. As per the Survey Report, it happened because of a misunderstanding of the management.

The credit union borrowings as on December 31, 1958, were only 6.08% of the value of the assets. This is much less than the statutory maximum limit of 25%. This fact, together with Table VII, indicate a sound liquid position of cash reserve funds in credit unions. Table VIII shows how the funds stated in the above table were constituted. An interesting feature of this table is that cash requirements in respect of shares and deposits were in almost every case carried in cash and demand deposits, except in the last two size groups. In these two groups there are some larger fishing and farming credit unions whose average savings per member are higher than in other credit unions, and appear to be less in need of cash balances.

To study the seasonal pattern of demand for borrowings by credit unions, the B.C. Credit Union Survey analysed the statistics shown in Tables IX and X, taken from the books of the B.C. Central Credit Union.

Because most of the credit unions carry their funds with, and obtain borrowings from, the B.C. Central Credit Union, the figures in the above-mentioned tables have been considered to be representative of the situation. Some bias is introduced, however, by the inclusion of loans made to cooperative associations in these figures. The Survey found

TABLE VIII

CONSTRUCTION OF FUNDS ON HAND OF ALL CREDIT UNIONS GROUPED ACCORDING TO THE AMOUNTS OF ASSETS

Size of Credit Unions (Thousand Dollars)	Cash and Demand Deposits	One Year Term Deposits	Bonds	Total
Up to 25	81,069	13,827	3,000	97,896
25 - 50	185,458	45,138	1,900	232,496
50 -100	349,182	134,526	11,021	494,729
100 -250	577,533	444,139	20,343	1,041,015
250 -500	546,198	460,915	64,850	1,071,963
500 -1,000	838,433	734,573	29,271	1,602,277
1,000-2,000	561,401	731,185	622,492	1,915,078
Over 2,000	615,641	646,756	--	1,262,397
Total	3,753,915	3,211,059	752,877	7,717,851

Source: B.C. Credit Union League, Survey Report, June 1960 (mimeographed), Vancouver, p. 60.

TABLE IX

EXCESS OF DEPOSIT BALANCES OVER LOAN BALANCES TO MEMBERS OF B.C. CENTRAL CREDIT UNION AT MONTH END FOR THE YEARS 1951-59 INCLUSIVE

(Thousands of Dollars)

Year	Jan.	Feb.	Mar.	Apr.	May	June	July	August	Sept.	Oct.	Nov.	Dec.
1951	242	160	177	163	201	192	76	202	196	252	254	390
1952	306	310	299	153	187	305	161	155	219	420	551	608
1953	440	344	255	10	(46)	115	48	202	315	475	693	570
1954	552	540	505	546	624	617	483	594	750	687	815	861
1955	1110	733	722	(565)	(17)	(158)	(339)	(110)	27	433	766	1063
1956	955	937	1085	918	264	131	(85)	72	301	636	1250	1507
1957	1365	1517	1090	451	(858)	(767)	(1139)	(1450)	(1147)	(1258)	(310)	(199)
1958	(2)	197	476	369	(240)	(284)	(595)	(583)	45	573	1334	1971
1959	1432	1535	1772	751	109	(298)	(1728)	(2098)	(1895)	(1546)	(768)	(12)

Source: B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 65.

TABLE X

RELATIONSHIP OF MEMBERS' LOANS TO MEMBERS' DEPOSITS WITH B.C. CENTRAL CREDIT UNION BY MONTHS FOR THE YEARS 1951-59 INCLUSIVE

(Expressed as percentages)

Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1951	86.9	84.9	82.4	84.2	80.8	82.4	81.6	80.3	83.5	79.1	79.9	71.8
1952	77.4	79.4	79.6	88.6	86.9	81.5	89.2	89.4	85.3	73.2	67.7	68.3
1953	75.3	80.8	86.3	99.4	102.7	93.8	97.3	89.1	84.2	76.6	67.7	75.5
1954	75.6	76.8	79.2	76.8	72.9	73.8	78.9	75.9	71.5	71.9	71.9	67.3
1955	60.5	74.4	75.9	127.8	100.6	105.5	113.2	103.8	99.1	86.7	77.8	72.0
1956	72.7	73.7	71.0	74.2	92.1	96.4	102.3	98.0	92.3	84.5	71.9	70.1
1957	70.5	67.9	76.7	89.9	122.4	116.5	125.9	134.1	123.7	126.9	105.9	103.4
1958	100.0	96.3	91.5	93.5	104.3	104.8	110.4	109.8	99.3	91.2	79.9	73.2
1959	78.4	76.8	75.6	88.8	98.3	103.6	128.4	133.8	128.5	123.2	110.9	100.1

Source: B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 65.

some kind of cycle from the above tables.

> A strange pattern is noted which has been observed by Dr. Croteau in A Study of Credit Union Growth and Liquidity. He states that there is something of a two year cycle in the borrowing pattern. During the 1950's the demand has been heavier in the "odd" years.[15]

The writer, however, does not see any cycle from these tables. The borrowings have been very erratic. This must have posed difficult problems to meet the cash requirements. In a year, the borrowings from May to October are heavier than other months.

4. Liquidity of B.C. Central Credit Union

Since the B.C. Central Credit Union is the depository of liquid funds of most of the credit unions in British Columbia, their liquidity is directly related to the liquidity of the B.C. Central. Further, its financial soundness is more important in the sense that it has to protect the cash reserves of the credit unions which have been deposited with it. B.C. Central should carry sufficient reserves to absorb all losses which may be occasioned by bad debts or marketable securities. The Canadian Cooperative Associations Act[16] requires that twenty per cent of annual net earning must be set aside as a guarantee reserve until the cumulative reserve amounts to ten per cent of the total of members' shares and deposits.

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[15] B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 65.

[16] Cooperative Credit Associations Act, S.C., 1952/53, c. 28.

For the purpose of appraising the financial soundness in general, and liquidity in particular, of the B.C. Central, the following tests will be made:

1) Examine the loaning practices, the securities for loans and loans turnover;
2) Study the extent of exercise of the borrowing rights;
3) Compliance with the Statutory Liquidity requirements.

The B.C. Central Credit Union has credit unions, cooperatives and societies as its members. In the past "central" has taken no securities against the loans granted to credit unions. There are two main reasons for this course of action. First, "central" has a statutory lien against the shareholdings and a set off against the deposit balances; and second, the credit union borrowings cannot exceed 25% of its assets. Thus four dollars worth of assets are behind every dollar of a loan. The loans to cooperatives and societies are normally secured by first mortgages on real estate, assignment of receivables, debentures, etc. The loans to these two groups as at December 31, 1959 were:

To credit unions	$5,423,942
To cooperatives and societies	2,528,430[17]

[17] The B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 69.

A large majority of loans to credit unions are short term, normally repayable within one year. This is evidenced from Table No. IX. Most of these loans are repaid on the maturity dates. But the B.C. Credit Union Survey, 1960, disclosed that some of the credit unions which fail to repay the instalments on time consider the loans as a part of their long term capital fund. The Survey Report recommended:

> Considering its first requirement is to secure the liquid position of Credit Unions "Central" would be well advised to guard against such a tendency. There are two sound reasons why - (1) from the Credit Unions position its twenty-five per cent borrowing right stands as a safety valve to obtain cash for withdrawals and to meet seasonal demands as they occur. Any type of permanent borrowing has the effect of minimizing the protective purpose of borrowing and actually increases the exposure of the Credit Union to the vagaries of economic conditions.
>
> (2) "Central's" funds become less liquid and as a result its ability to spread assistance at times of peak demands and to meet difficult local conditions is lessened in direct proportion to the amount of long-term loans outstanding. In this respect a long-term bond has equal disadvantages except that normally a market exists through which its current value can be realized on short notice.[18]

Table XI shows the loan activity for the last ten years. It gives some indication of the rapid turnover of the loans. If it is assumed that all loans are of equal term and the repayments are evenly distributed throughout the year, the average turnover of loans will be approximately seven months. This shows that the borrowings from the B.C. Central Credit Union are of very short term.

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[18] B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 69.

TABLE XI

LOAN ACTIVITY B.C. CENTRAL CREDIT UNION FROM 1950 TO 1959 INCLUSIVE, SHOWING AVERAGE REPAYMENT PERIOD ASSUMING EQUAL TERMS ON ALL LOANS AND EQUAL MONTHLY INCIDENCE

Year	Balance Forward	Loans Made	Total	Loans Repaid	Percentage Balance of Loans repaid to Total
1950	721,475	1,311,109	2,032,585	1,163,325	57.23
1951	869,259	1,555,717	2,424,977	1,151,610	47.48
1952	1,273,367	1,416,639	2,690,007	1,350,780	50.21
1953	1,339,227	2,874,386	4,213,613	2,296,324	54.49
1954	1,917,288	3,765,013	5,682,302	3,414,202	60.08
1955	2,268,099	2,863,326	5,131,426	2,422,946	47.21
1956	2,708,480	6,814,586	9,525,066	5,996,917	62.97
1959	3,526,148	8,726,340	12,252,489	6,280,780	51.26
1958	5,971,709	9,425,246	15,396,955	10,009,369	65.00
1959	5,387,586	12,503,422	17,891,009	9,938,636	55.55
	25,972,643	51,255,759	77,238,433	44,024,902	57.10

Source: B.C. Credit Union League, Survey Report, June 1960 (mimeographed), Vancouver, p. 70.

The extent of the exercise of the borrowing rights of the B.C. Central throws some light on its liquidity. Table XII shows the borrowings for the last five years. High percentages in 1957 and 1959 are caused by fluctuations in the business cycle. Bond prices dropped and loans made to credit unions increased in relation to the repayments received. It can be seen from Table XI that during these years the B.C. Central was not left with much margin for further borrowings. It is evident that credit union liquidity can be seriously affected by rather acute fluctuations in the economic cycle. Since the B.C. Central Credit Union supplies almost the whole of credit union borrowings, a slightly more acute turn in the economy could bring about a significant impairment of liquidity.

Table XIII shows how well the B.C. Central Credit Union complied with the statutory requirements of the <u>Canadian Cooperative Credit Associations Act</u>.[19] The cash situation all along has been very satisfactory.

Table XIV presents the comparative picture of the B.C. Central Credit Union with loan companies, trust companies and chartered banks, regulated by the Department of Insurance, Ottawa. It is evident from this table also that the B.C. Central operates well within the statutory requirements.

From the study of all these schedules it is evident that the B.C. Central Credit Union has been very ably managed.

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[19] <u>Cooperative Credit Associations Act</u>, S.C. 1952/53, c.28.

TABLE XII

COMPARISON OF STATUTORY BORROWING RIGHTS B.C. CENTRAL CREDIT UNION WITH ACTUAL BORROWINGS AT 31 DECEMBER, 1955 TO 1959 INCLUSIVE

	1955	1956	1957	1958	1959
Paid Capital	453,703	768,205	745,580	873,765	1,008,355
Guarantee Fund	23,487	34,288	49,101	70,628	70,353
Surplus	22,502	17,124	22,733	20,535	--
Total	499,694	819,617	817,414	964,928	1,078,708
10 times total	4,996,940	8,196,170	8,174,140	9,649,281	10,787,080
Deposits	3,659,352	4,968,072	5,830,547	7,295,024	7,427,373
Bank Loan			1,570,547	--	2,353,000
Bank Overdrafts				59,731	54,807
Total	3,659,352	4,968,072	7,401,044	7,354,756	9,835,181
Unused Borrowings	1,337,597	3,228,101	773,051	2,294,532	951,906
Percentage of actual borrowings to limit	73%	61%	91%	76%	91%

Source: B.C. Credit Union League, Survey Report, June 1960 (mimeographed), Vancouver, p. 71.

TABLE XIII

STATUTORY LIQUIDITY REQUIREMENTS AS PROVIDED FOR IN CO-OPERATIVE CREDIT ASSOCIATIONS ACT FOR THE YEARS 1955 TO 1959 INCLUSIVE AS APPLIED TO FINANCIAL REPORTS OF B.C. CENTRAL CREDIT UNION

	1955	1956	1957	1958	1959
5% of total deposits	182,967	248,403	291,527	364,751	371,368
Cash balances	647,728	852,770	892,779	1,070,429	1,187,677
Excess over requirements	464,761	604,367	601,252	705,678	814,308
Percentage cash to requirements	354%	343%	306%	293%	319%
20% of total deposits	731,870	993,614	1,166,109	1,459,004	1,485,474
Cash balances	647,728	852,771	892,780	1,070,429	1,185,677
Bonds--Can. and Prov. Govts. their guarantees (less pledged)	809,567	1,303,264	477,935	1,525,987	703,155
Total cash and bonds	1,457,295	2,156,035	1,370,715	2,596,416	1,888,832
Excess over requirements	725,425	1,162,421	204,606	1,167,412	403,358
Percentage total cash and bonds to requirements	199%	217%	118%	178%	127%

Source: B.C. Credit Union League, Survey Report, June 1960 (mimeographed), Vancouver, p. 72.

TABLE XIV

COMPARATIVE FIGURES OF INSTITUTIONS UNDER THE SUPERVISION OF DEPARTMENT OF INSURANCE, OTTAWA

	1958 B.C. Central	All Loan Companies (a)	All Trust Companies (a)	All Canadian Chartered Banks (a)
1. Liquidity				
(1) 5% of total deposits	364,751	6,222,203	6,686,017	598,700,000
Cash on hand and on deposit in banks	1,070,429	7,382,089	9,213,846	998,000,000
Percentage of cash to limit	293%	119%	138%	158%
(2) 20% of total deposits	1,459,005	24,888,812	26,744,071	2,394,800,000
Cash, Govt. and Municipal bonds	2,596,416	50,852,154	100,131,799	4,400,000,000
Percentage of cash and bonds to limit	178%	204%	374%	184%
2. Limit of borrowings (10 x paid capital, reserves and surplus	9,649,288	437,644,770	340,196,440	740,000,000
Deposits and borrowed money	7,354,756	352,092,793	237,741,692	11,974,000,000
Percentage of borrowings to limit	76%	80%	70%	1618%
		Can. Perm. Mtge.	Canada Trust	
3. Maximum limit on single loan	816,878	8,324,463	5,283,328	N.A.
Largest loan made	600,000	3,756,999	403,551	

NOTE: (a) These companies have not, of course, the same limitations as the B.C. Central, but for comparative purposes, we have assumed they have.

Source: Letter no. 17-2-1 dated December 2, 1959, of Assistant Superintendent of Insurance, Dept. of Insurance, Ottawa, addressed to Mr. F. Graham, C.A., Vancouver, B.C.

It is fortunate for the credit union movement in British Columbia that its "central bank" has all its affairs beautifully in control.

After having appraised the financial soundness of credit unions in British Columbia, we will study their lending practices in the next chapter.

CHAPTER III

LENDING PRACTICES

A credit union is essentially a non-profit organization, owned and operated by its members. Rule 54 of the standard rules of the B.C. Credit Union Act provides that:

> The committee shall inquire carefully into the character and financial condition of each applicant for a loan, and of his sureties, if any, in order to ascertain his ability to fulfil the obligations assumed by him, and shall determine whether the loan sought is for a provident, productive, or merchandising purpose, and will be of probable benefit to the borrower.[1]

The committee mentioned is the credit committee. The purpose may include consolidation of debts, purchase of automobile, home repairs, vacations, education, payment of medical bills, taking advantage of financial opportunities, family emergencies and so forth.

The lending practices of credit unions in British Columbia will be studied from the following angles:

(a) the purposes for which loans have been taken;

(b) the nature of security taken;

(c) the rate of interest charged;

(d) the terms of repayment.

I. PURPOSE OF THE LOAN

There are difficulties in recognizing exactly the

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[1]*Credit Unions Act*, R.S.C. 1948, c. 82, Constitution and Rules, Rule 54.

purpose for which certain loans are made. For example, in all innocence a month's rent money may be used to buy some household equipment, and a loan of the same amount may be taken from a credit union stating as its purpose the payment of rent money. There are also possibilities that the intended purpose might be deliberately concealed by the borrower because the disclosure of the true purpose would impair his chances of getting the loan. The following statistics should be evaluated in light of the obstacles impeding exactitude in a study of this kind.

The B.C. Credit Union Survey sent out a questionnaire to all the credit unions in the Province, asking questions on various aspects of lending practices of credit unions during the year 1957. Replies representing 87.1% of the total number, and 95% of the total assets of the credit unions, were received.

The question dealing with the purpose of loans was: "During the past twelve months, what proportion of your loan activity, dollarwise, was made for: ---- (estimate). The answers were tabulated and are shown in Table XV. This table shows that quite a large percentage of total lending by small and medium-sized credit unions is for the purpose of buying real estate which would usually involve relatively large loans. It is a debatable point from the standpoint of the economic needs of the community whether smaller credit unions should indulge extensively in real estate loans. The

TABLE XV

B.C. CREDIT UNIONS: PERCENTAGE DISTRIBUTION OF AMOUNT OF LOANS GRANTED, BY PURPOSE

Size of Credit Union Assets (Thousand Dollars)	Consolidation of Debts	Purchase of Private Cars	Purchase of Commercial Cars and Trucks	Purchase of Household Equipment	Home Improvement	Purchase of Land and Buildings	Fishing Boats and Gear	Medical Bills	Other	Total
				- Per Cent -						
Up to 25	22	15	3	11	14	9	1	4	21	100
25 - 50	17	28	2	10	12	14	1	3	13	100
50 -100	17	21	3	10	12	18	1	3	15	100
100-250	15	26	4	9	13	17	1	2	13	100
500-1,000	12	22	1	7	15	25	1	2	15	100
1,000 and over	13	18	2	5	10	23	7	1	21	100
Average	13	20	2	7	14	21	4	2	17	100

Source: B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 31.

answer, to some extent, depends on the demand for small consumer loans. The credit union that encourages loans which closely approximate the consumption needs of the community is certainly performing a useful service.

There are no recent comparable statistics either in Canada or in the United States. A study regarding the purposes for which credit union members borrow was made in 1949 by Edris W. Smith of the Bureau of Federal Credit Unions, U.S.A. This study was based on a sample of 10.6% of the federal credit unions in operation on December 31, 1948, and covered the loans made during that year. Though the purposes in this study have not been categorised in the same way as was done in the British Columbia Survey, it is interesting to note some comparative figures. Further, this study does not break down the loan distribution according to different sizes of credit unions.

Recasting Table XV in a pattern based on current consumer credit classification, it would perhaps be more indicative of the purposes of credit union borrowing.

It would seem from Table XVII that the largest percentage of money loaned, 41%, is for the purchase of durables; real estate comes next with 21% of the total amount loaned; while convenience credit, emergency credit and business investment take third, fourth and fifth positions respectively. There is, however, a very thin line dividing the emergency credit and the convenience credit. Though the writer would

TABLE XVI

FEDERAL CREDIT UNIONS: PERCENTAGE DISTRIBUTION OF NUMBER AND AMOUNT OF LOANS GRANTED, BY PURPOSE, 1948

Purpose	Percentage Distribution	
	Number of Loans	Amount of Loans
Consolidation of debts	15.4	14.9
Purchase of automobiles	7.5	21.3
Household furniture and appliances and other durable consumer goods	7.4	6.8
Home repair expenses	7.2	9.5
Medical, dental and hospital expenses	15.3	10.3
Payment of:		
Taxes	3.9	2.5
Funeral expenses	.6	.5
Insurance premiums	2.0	1.2
Current living expenses	16.1	9.6
Vacation expenses	5.9	3.4
Educational expenses	1.7	1.2
Investment in:		
Business ventures	1.3	4.5
Stocks, bonds, etc.	.3	.5
All others	15.4	13.8
Total	100.0	100.0

Source: Edris W. Smith, "Federal Credit Union Loans, 1948", Social Security Bulletin, Vol. 12, No. 7 (July 1949). (Items have been reorganized).

TABLE XVII

B.C. CREDIT UNIONS: PERCENTAGE DISTRIBUTION OF AMOUNT OF LOANS GRANTED, BY PURPOSE, ACCORDING TO CONSUMER CREDIT CLASSIFICATION

Size of Credit Union Assets (Thousand Dollars)	Emergency Credit (Medical bills and 2/3 of "other" Expenses	Purchase of Durables (Private automobiles, household equipment, home improvements)	Convenience Credit (Consolidation of debts and 1/3 of "other" Expense)	Business Investments (Commercial cars, Trucks, Fishing Boats and Gear	Real Estate	Total
Up to 25	18.0	40.0	29	4	9	100
25-50	11.6	50.0	21.3	3	14	100
50-100	13.0	43.0	22.0	4	18	100
100-250	10.6	48.0	19.4	5	17	100
250-500	11.3	48.0	18.7	3	19	100
500-1,000	12.0	44.0	17.0	2	25	100
1,000 and over	15.0	33.0	20.0	9	23	100
Average	13.3	41.0	18.7	6	21	100

Source: Based on B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 31.

refrain from drawing any definite conclusion from these statistics because they are based on estimates, it would seem that the credit unions in this Province are drawing away from the "rainy day" theory of cooperative credit.

The other major consumer lending institutions are consumer finance companies, instalment finance companies, and banks. Similar statistics for these institutions which would be representative of the practices in the whole of Canada are not available, but the experiences of one large consumer finance company and the main branch of a large bank in Vancouver are given in Appendix 1. One cannot, however, make any generalizations from this information.

II. NATURE OF THE SECURITY TAKEN

Vide section 18(5) of the B.C. Credit Unions Act:

> No loan of any amount exceeding two hundred dollars shall be made without security therefor in addition to the obligation or covenant of the borrower: Provided that the Inspector may authorize a credit union on application by it, to make loans exceeding the sum of two hundred dollars but not exceeding the sum of four hundred dollars, without security therefor other than the covenant of the borrower, and in giving such authority the inspector may impose such conditions as he deems advisable.[2]

This is an unreasonably restrictive provision. In the statutes of most of the American states, the boards of directors have been empowered to set the unsecured loan limit.

[2] Credit Unions Act, R.S.C. 1948, c. 82, s. 18(5).

Some stipulate five hundred dollars as the maximum limit to which the board of directors may authorize the credit committee to act without security for the loan. There are others imposing different limits. It is commonly believed in banking circles that almost all of the credit union loans are secured. The reason for this can to some extent be attributed to this statutory limit. When the credit committee finds an applicant for more than $200 a good credit risk, some minor security like comaker or chattel mortgage on household effects is introduced to circumvent the provisions of the Act.[3] In fact there is no intention of obtaining the security, and if the statutory restriction had not existed, no security would have been taken. In reality, loans like that may be called unsecured or character loans.

The B.C. Credit Union Survey indicates that the percentage of unsecured loans is quite small:

> If we remove the group of endorsers and the amount of shares pledged, the percentage of one signature loans is small.[4]

Dr. E.R. Isbell, in his paper "Credit Unions and the Recession",[5] mentions that in the United States less than three per cent of credit union loans are unsecured whereas the banks and the personal finance companies have 65% and 25% respectively.

Although character loans are comparatively small in

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[3]Mr. J.F. Quail, Field Representative, B.C. Credit Union League, Vancouver.

[4]B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 43.

[5]Dr. E.R. Isbell, Credit Unions and Recession, Ohio Credit Union League Workshop, 1959, p. 53.

volume, the element of character of the borrower in any type of loan is important. From the point of view of service to the community for which it professedly stands, a credit union has to see that the loans are repaid from the normal earnings of the borrower, and not through the liquidation of securities. There are four C's of credit--character, competence, capital, and business conditions. If a potential user of the credit has the first two C's and the lending institution has the latter two, it is an ideal situation to grant credit. Though the credit unions have to apply this yardstick in judging the credit worthiness of a borrower, they generally do not demand the same degree of positive qualities of a borrower as is done by other lending institutions. Credit union lending mostly goes to the people who cannot obtain effective advantage of other institutions. This is affirmed by the statement of the Royal Commission on Cooperatives, 1945:

> We are satisfied that credit unions perform a highly useful function in assisting people who are unable to take effective advantage of savings and loan facilities provided by other lending institutions.[6]

It is not easy to judge the risk worthiness of a credit user. Not only are such evaluations of relative quality, but they are also distorted by personal bias.

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[6]Report of the Royal Commission on Cooperatives, King's Printer, Ottawa 1945, p. 52.

> From a psychological standpoint the character of person is that aspect of his personality that involves his moral principles and values.[7]

If he sticks to the moral principles and recognises their values, he will do his best to fulfil the obligations he has undertaken. A person derives some traits of his personality from his experience. This is generally on account of the influence of one's home and associates. Apart from this, there is the quality of self-reliance in a person. How he has learned to assume the responsibilities of his life is quite important. The second "C" is competence, the ability to handle the financial matters.

> Competence depends upon two things, namely, the person's ability and his background of experience.[8]

Ability is displayed by the ways a person organizes his affairs, whether he has stability in employment and so on. Generally because of the closeness of the bond between credit union members, the investigation of these values of an individual is not too difficult; nevertheless, their evaluation is always a problem. The growth of the credit unions has been so spectacular that some of them have a membership of over six thousand. For such cases, the ties of common bond become insignificant, and credit investigation all the

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[7] S.N.F. Chant, "The Credit Risk--A Psychological Analysis of the Credit User", appeared in Readings on Credit and Collections in Canada, Ryerson Press, Toronto, 1958, p. 25.

[8] *Ibid.*, p. 23.

more difficult.

There are credit unions that serve the communities which have transient populations. The credit committee in such cases has a limited basis by which to judge the credit worthiness of a person. However, considerations like family unit, and the habit of sticking to a job, might help in making a judgment. In the B.C. Credit Union Survey, certain categories of borrowers were singled out and a course of action suggested to deal with them.

There is no data available to show the amount of unsecured loans made by the credit unions in British Columbia and their experience regarding bad debts on such loans.

There are various kinds of securities taken by credit unions such as chattel mortgage, an assignment of life insurance bonds, real estate, comaker, etc. In order to assess the worth of a security, one has to go beyond what appears on the face of it. The value of the bond depends upon its yield. When corporation shares are taken as security, their market price is important. In the case of chattel mortgages, real estate mortgages, and the assignment of life insurance, the legal requirements for the transaction should be fulfilled. For real estate mortgages, it has to be ascertained that the property is insured for fire and destruction.

It is fairly common amongst small credit unions that chattel mortgages are not registered. Cases have appeared where the credit union could not have recourse against the property because its chattel mortgage was not registered, and some other party had a valid registered chattel mortgage. Regarding life insurance policies, it is always advisable that the cash surrender value of the policy at the time of the assignment is confirmed by the insurance company. The date the last premium was paid should be verified. The treasurer should register the assignment of the policy with the insurance company forthwith. Further, the treasurer should occasionally verify from the insurance company that the premiums are regularly paid, because notwithstanding any assignment, the insurance company has prior claim against the cash value of the policy for the unpaid premiums.

Tables XVIII and XIX show the percentage distribution of loans by amounts and by numbers according to the type of security taken. Table No. XX gives the modal values.

More than half of the number of loans, and one-quarter of the total amount of loans were made with only signature and shares as the security. 18.14% of total number of loans were comaker loans. The security of real estate is quite popular, accounting for 32.95% of the total amount loaned, and 12.43% of the total number of loans. It is quite interesting to note that in small credit unions, tangible securities like chattel mortgages and real estate constitute security for a small part of the volume of loans, whereas intangible securities like comaker, signature, and share loans constitute the major portion. The situation is the other way around in the

TABLE XVIII

NATURE OF SECURITIES LODGED WITH CREDIT UNIONS ON LOANS GRANTED DURING PERIOD FROM JULY 15TH TO SEPTEMBER 30TH, 1957, EXPRESSED AS A PERCENTAGE OF TOTAL AMOUNT OF LOANS APPROVED

Size of Credit Union Assets (Thousand Dollars)	Bonds	Life Insurance	Real Estate	Vessels	Automobiles	Household Effects	Co-maker	Signature and Shares	Total
				- Per Cent -					
Up to 25	--	.21	7.08	--	13.02	2.72	30.28	46.69	100
25 - 50	3.95	.67	12.20	--	26.79	3.66	26.30	26.43	100
50 - 100	.23	.52	16.27	.20	11.59	3.20	37.66	30.33	100
100 - 250	1.03	.64	26.36	.17	19.84	3.77	23.85	24.34	100
250 - 500	3.13	.49	34.66	.79	15.82	3.48	23.28	18.35	100
500 - 1,000	1.28	.69	33.01	.34	14.80	5.51	14.43	29.94	100
1,000 - 2,000	2.15	1.20	30.62	1.13	18.30	4.61	14.67	27.32	100
Over 2,000	.30	1.38	56.10	3.08	12.70	.30	7.97	18.17	100
Average	1.61	.85	32.95	.97	16.28	3.63	18.69	25.02	100

Source: B.C. Credit Union League, Survey Report, June 1960, Vancouver (mimeographed), p. 34.

TABLE XIX

NATURE OF SECURITIES LODGED WITH CREDIT UNIONS ON LOANS GRANTED DURING PERIOD FROM JULY 15TH TO SEPTEMBER 30TH, 1957, EXPRESSED AS A PERCENTAGE OF NUMBER OF LOANS APPROVED

Size of Credit Union Assets (Thousand Dollars)	Bonds	Life Insurance	Real Estate	Vessels	Automobiles	Household Effects	Co-maker	Signature and Shares	Total
				- Per Cent -					
Up to 25	--	.15	2.25	--	4.04	1.20	21.14	71.22	100
25 - 50	5.87	.43	5.01	--	11.87	2.00	19.75	55.07	100
50 - 100	.29	.40	5.52	.16	5.44	2.87	27.20	58.12	100
100 - 250	1.11	.48	10.50	.16	10.61	2.92	21.01	53.21	100
250 - 500	12.76	.49	15.96	.21	9.40	2.95	19.53	38.70	100
500 - 1,000	.97	.82	12.01	.19	8.20	4.24	14.58	58.99	100
1,000 - 2,000	2.19	.93	12.35	.22	9.08	3.38	15.90	55.95	100
Over 2,000	.55	2.11	25.92	.70	9.87	.31	11.76	48.78	100
Average	3.45	.76	12.43	.22	8.82	2,88	18.14	53.30	100

Source: B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 34.

TABLE XX

MODAL VALUES OF LOANS GRANTED DURING THE PERIOD FROM JULY 15TH TO SEPTEMBER 30TH, 1957, GROUPED AS TO DIFFERENT TYPES OF SECURITIES LODGED IN RESPECT OF SUCH LOANS

Size of Credit Union Assets (Thousand Dollars)	Bonds	Life Insurance	Real Estate	Vessels	Automobiles	Household Effects	Co-maker	Signature and Shares
			- In Dollars -					
Up to 25	--	400	300	--	700	700	300	100
25 - 50	100	500	1000	--	640	600	400	100
50 - 100	300	600	2000	100	840	400	300	100
100 - 250	200	600	2000	500	950	500	300	100
250 - 500	100	300	1000	3000	700	1500	300	100
500 - 1,000	200	100	500	1500	1030	300	300	100
1,000 - 2,000	100	800	1000	2900	950	1000	500	100
Over 2,000	200	600	2000	8600	1520	1130	500	100

Source: B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 35.

case of larger credit unions. One conclusion that can be drawn is that with the growth in size of a credit union, there are enough surplus funds to permit real estate loans and other large amount loans which would require tangible securities. This conclusion is reinforced by Table XX where the modal values of loans involving real estate, vessels and automobiles as security, are fairly large.

It was remarked previously that some credit unions do not comply with the legal requirements in taking in securities. In many cases, chattel mortgages on automobiles and household effects are not registered. This fact is exhibited in Tables XXI and XXII. There could be three reasons for this omission--either ignorance of law, carelessness on the part of the management of a credit union, or the fact that these securities are only taken to put moral pressure on the borrower to pay instalments on time. It is surprising to find that some of the large credit unions with well qualified management commit this mistake.

Very few credit unions have ever taken recourse against a mortgage on household effects. In fact, it is a kind of character loan in excess of the maximum loan amount permitted under the Act. Even if a credit union tries to realise this security, it will not obtain enough money to pay off the debt, apart from displeasing the borrower. Nevertheless, if a security is taken, it should be legally workable. As evident from Table XXI, the insurance policies on automobiles are sometimes not endorsed. In case of the destruction of the

TABLE XXI

PERCENTAGE AMOUNT OF CHATTEL MORTGAGE NOT REGISTERED AND PERCENTAGE AMOUNT OF INSURANCE ON AUTOMOBILE NOT ENDORSED, OF TOTAL AMOUNTS OF LOANS GRANTED IN DIFFERENT SIZE GROUPS OF CREDIT UNIONS, ON THE SECURITY OF CHATTEL MORTGAGE ON AUTOMOBILES IN THE PERIOD FROM JULY 15TH TO SEPTEMBER 30TH, 1957

Size of Credit Union Assets (Thousand Dollars)	Amount of loans on security of chattel mortgage on automobiles	Percentage of loans on security of chattel mortgage on automobiles of Total Loans	Percentage (amounts) chattel mortgages not registered	Percentage (amounts) Insurance on automobiles not Endorsed
Up to 25	$ 24,439	1.74	20.2	61.1
25 - 50	78,697	5.61	19.2	51.1
50 - 100	67,776	4.83	7.0	61.2
100 - 250	236,176	16.82	4.1	40.6
250 - 500	241,640	17.21	7.7	27.8
500 - 1,000	238,555	16.99	1.6	47.5
1,000 - 2,000	350,479	24.96	3.7	29.8
Over 2,000	166,249	11.84	4.6	35.5
	1,404,011	100.00	5.56	35.5

Source: B.C. Credit Union League, <u>Survey Report</u>, June 1960, (mimeographed), Vancouver, p. 41.

TABLE XXII

PERCENTAGE OF CHATTEL MORTGAGE ON HOUSEHOLD EFFECTS NOT REGISTERED, OF TOTAL AMOUNTS OF LOANS GRANTED IN DIFFERENT SIZE GROUPS OF CREDIT UNIONS, ON THE SECURITY OF CHATTEL MORTGAGE ON HOUSEHOLD EFFECTS, DURING THE PERIOD FROM JULY 15TH TO SEPTEMBER 30TH, 1957

Size of Credit Union Assets (Thousand Dollars)	Amount of loans on the security of chattel mortgage on household effects	Percentage of total loans	Chattel not Registered	Percentage not Registered
Up to 25	5,095	1.63	$1,000	19.6
25-50	10,762	3.44	4,478	41.6
50-100	18,730	5.97	4,342	23.2
100-250	44,851	14.30	15,323	34.2
250-500	53,219	16.96	4,929	11.0
500-1,000	88,831	28.30	23,688	26.6
1-2,000	88,330	28.14	8,234	9.3
Over 2,000	3,931	1.26	960	24.4
	313,749	100.00	62,954	20.1

Source: B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 42.

vehicle, the credit union has nothing to fall back upon except the borrower's personal covenant. It is also important in the case of automobile securities that the rate of repayment on the loan exceeds the rate of depreciation. Otherwise a time might come when the security is worth nothing, and the full amount of the loan has not been liquidated.

There are various forms by which charges on the real estate may be held: mortgage, conditional sale agreement, deposit of title agreement, and certificate of title. There are so many complexities in these agreements that it is always advisable to employ the services of a legal practitioner. The B.C. Credit Union League has printed an agreement form which should accompany the deposit of title. In this agreement the terms under which the deposit of title is made are stated, and the borrower stipulates that he will execute the registered mortgage when required by the credit union. The "League" has always recommended that this type of security should only be accepted when the amount of the loan is less than one thousand dollars. When taking these securities, the credit union should take into consideration the extent of depreciation during the term of the loan.

The following table shows different kinds of charges accepted by credit unions in real estate loans. It may be remarked here that this table does not present a true picture regarding small credit unions, because the survey covers eleven

TABLE XXIII

ANALYSIS OF REAL ESTATE LOANS GRANTED FROM JULY 15TH TO SEPTEMBER 30TH, 1957 AS TO THE FORM OF SECURITY--GIVING THE PERCENTAGE AND THE MODE UNDER EACH CATEGORY ACCORDING TO THE SIZE GROUPS OF CREDIT UNIONS

Size of Credit Union Assets	Registered First Mortgage	Registered Second Mortgage	Registered Assignment of Agreement for Sale	Deposit of Title Agreement	Certificate of Title	Total
1-25,000						
Percentage of total Real Estate Loans	26.7%	3.8%	--	13.6%	55.9%	100.0%
MODE	435	500	--	500	500	--
25,000-50,000						
Percentage of total Real Estate Loans	23.8%	--	2.8%	60.8%	12.6%	100.0%
MODE	1,000	--	1,000	1,000	500	--
50,000-100,000						
Percentage of total Real Estate Loans	44.7%	--	20.7%	22.3%	12.3%	100.0%
MODE	1,500	--	700	300	500	--
100,000-250,000						
Percentage of total Real Estate Loans	49.7%	2.4%	1.3%	30.0%	16.6%	100.0%
MODE	500	2,000	1,610	600	300	--

- continued -

TABLE XXIII (continued)

Size of Credit Union Assets	Registered First Mortgage	Registered Second Mortgage	Registered Assignment of Agreement for Sale	Deposit of Title Agreement	Certificate of Title	Total
250,000-500,000 Percentage of total Real Estate Loans	33.7%	20.0%	7.7%	26.3%	12.3%	100.0%
MODE	2,000	2,000	1,000	1,000	500/1,000	--
500,000-1,000,000 Percentage of total Real Estate Loans	63.8%	3.7%	5.8%	23.3%	3.4%	100.0%
MODE	1,000	2,400	500	300	500	
1,000,000-2,000,000 Percentage of total Real Estate Loan	60.7%	2.6%	4.9%	27.1%	4.7%	100.0%
MODE	500	1,500	2,000	1,000	1,000	--
2,000,000 and over Percentage of total Real Estate Loans	35.5%	7.0%	4.3%	34.9%	18.3%	100.0%
MODE	2,000	2,000	1,400	1,000	2,000	--

Source: B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 37.

weeks only, and small credit unions have only a small percentage of real estate loans. Second mortgages do not seem to be very common.

As the amount of the real estate loan should relate to the current value of the property, it is essential that some method be employed by the credit union to assess the value. The B.C. Credit Union Survey[9] indicates that 59.2% of real estate loans were granted without any appraisal of the property involved. Most of the appraisals out of the other 40.8% were made by credit union officers. This is a serious omission and the credit unions should appraise the property before taking it as security.

It is always desirable that the fire insurance policies on real estate be endorsed payable to the credit union at the time a loan is granted. Almost one-half of the amounts of such policies are without endorsement.[10] More particularly, the small credit unions seem to be unaware of the importance of this protective step.

III. RATE OF INTEREST

The B.C. Credit Union Act requires that:

> The rate of interest on a loan shall not exceed one per centum for each month, inclusive of all charges for making the loan, and shall be payable only on the unpaid balance.[11]

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[9] B.C. Credit Union League, Survey Report, June, 1960, (mimeographed), Vancouver, p. 39.

[10] Ibid., p. 40.

[11] Credit Union Act, R.S.C. 1948, c. 82, s. 8 ss. 7.

There is no standard rate of interest amongst the credit unions in British Columbia. The setting of rates of interest in different credit unions depends on a large variety of considerations. In larger credit unions, the rate of interest on personal loans may sometimes be close to 12% per annum, but real estate loans would have a somewhat lower rate. Similarly, some credit unions charge a lower rate of interest on loans which are secured by shares. The B.C. Survey Report divided the credit unions which do not differentiate between types of loans into three groupings of interest rates:

(1) One rate only between 6% and 12% per year.

(2) Multiple rates 12% on the first part of the loan (last to be repaid) and ranging from 6% to 9% on the balance of the loan in different credit unions.

(3) Same as in (1) and (2) with 6% per annum to apply on an amount equal to member's share balance at time loan is made and frozen as security.[12]

Table XXIV presents the percentage of the number of credit unions in each category.

The interest charge in itself does not present a true picture, because a large percentage of credit unions make

[12] B.C. Credit Union League, op. cit., p. 14.

TABLE XXIV

SINGLE RATES ALL LOANS BY NUMBER OF CREDIT UNIONS
(Assets in $ Thousands)

Total Assets	$1-25	$25-50	$50-100	$100-250	$250-500	$500-1000	Over $1000
Rates							
12%	40%	22%	13%	13%	6%	2%	2%
9%	1%	--	--	5%	1%	1%	--
8%	--	--	--	1%	1%	1%	--
7%	--	--	1%	--	--	--	--
6%	--	--	--	2%	1%	--	2%
MULTIPLE RATES ALL LOANS BY NUMBER OF CREDIT UNIONS							
Rates							
12% between $200-1200 Balance 6%	8%	7%	10%	2%	6%		2%
12% on loans between $300-1000 Balance 7-8-9%	1%	1%	1%	2%	1%	1%	--
9% up to $2,000 Balance 7% Reduced rate on security of shares	2%	1%	1%	2%	3%	1%	--
MULTIPLE RATE PER TYPE OF LOAN--PERSONAL, REAL ESTATE, EDUCATIONAL BY NUMBER OF CREDIT UNIONS							
12% Personal Loans 6-9% Real Estate Loans	1%	2%	2%	7%	1%	2%	1%

- continued -

TABLE XXIV (continued)

	$1-25	$25-50	$50-100	$100-250	$250-500	$500-1000	Over $1000
9% Personal Loans 6-8% Real Estate Loans				2%			1%
12% Personal Loans 6-7 1/2% Real Estate Loans 6% shares as security				1%	1%	1%	1%
Personal 12% up to $300 6% on balance 7% Real Estate Loans 7% shares as security							
Personal 12% up to $500 6% on balance 7-8% Real Estate			1%	1%	1%	1%	
All Loans 12% 4-6% Education							2%

Source: B.C. Credit Union League, _Survey Report_ June 1960, (mimeographed), Vancouver, p. 13.

interest refunds at the end of the year. Table XXV shows the refunds made during the last two years.

TABLE XXV

CREDIT UNIONS - INTEREST REFUNDS

Year	Total No. of Credit Unions	No. of Credit Unions making Refunds	% Credit Unions making Refunds to Total	Rate of Refund to Total Interest Paid
1959	326	168	51.5	10%
1958	317	110	34.7	10%

Source: 1960 Credit Union Year Book; 1959 Credit Union Year Book, Credit Union National Association, Madison, Wisconsin.

The Consumer Finance Companies are regulated by the Small Loans Act 1939 as amended by Bill 51, August 6, 1956. The permitted rate of charge on loans up to $1500 is as follows:

(a) The cost of a loan shall not exceed the aggregate of
 (1) two per cent per month on any part of the unpaid principal balance not exceeding three hundred dollars,
 (2) one per cent per month on any part of the unpaid principal balance not exceeding three hundred dollars,
 (3) one-half of one per cent per month on any remainder of the unpaid principal balance exceeding one thousand dollars.

(b) Where a loan of five hundred dollars or less is made for a period greater than twenty months or where a loan exceeding five hundred dollars is made for a period greater than thirty months, the cost of the loan shall not exceed one per cent per month on the unpaid principal balance thereof.

(c) No charges can be paid, deducted or received in advance.[13]

[13] Bill 51, An Act to Amend the Small Loans Act, August 6, 1956, The Queen's Printer and Controller of Stationery, Ottawa, 1956.

There are no statistics available to show what rate of interest is actually charged by Consumer Finance Companies. J.G. O'Sullivan, reviewing the interest rates, said:

> In the past some lenders, usually the large companies, have seen fit to reduce rates to a figure below the 2% maximum allowed. However, rising costs have forced almost all lenders to revert back to maximum charge of 2%.[14]

This was the situation in 1953 prior to the amendment of the Small Loans Act. Now when the maximum interest rate has been somewhat lowered, it is most probable that the Consumer Finance Companies are charging the maximum rate.

Under the Bank Act[15] the chartered banks are allowed to charge interest rates up to the maximum of 6% per annum on the average amount of loan outstanding. In practice, almost all the banks charge 6% per annum on personal loans. Above that, service charges are made which are based on the amount and the term of loan. Some banks credit the repayments on a personal loan to the savings account of the borrower. After the end of the term of a loan, total repayments made are transferred to the loan account. By this device, a bank is able to charge a higher price on loans because the interest rate generally paid on the savings account is less than 3% per annum and the interest rate charged on the personal loan

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[14] J.G. O'Sullivan, "Personal Loan Companies", Credits and Collections in Canada 1953: The Ryerson Press, Toronto, p. 72.

[15] Bank Act, S.C., 1953/54, c. 48.

is 6% per annum. The overall charge generally comes to between 10 and 12 per cent per annum. The Royal Bank of Canada deserves mention here. As per inquiries of the writer, this is the only bank in Vancouver which does not make any service charges over and above 6% interest rate on the average amount of loans outstanding.

IV. TERM OF LOANS

The credit unions professedly grant short term loans. There is an increasing trend toward real estate loans which are normally long term. To maintain liquidity, the credit unions should restrict long term loans. Table XXVI shows the maturity of loans granted during the period from July 15th to September 1957. 84.48% of the total loans will be fully paid within two years and three months. Almost 33% of these loans are real estate loans which are supposedly long term. This shows that the loans are kept on a reasonably short term basis.

Having studied the financial condition of the credit unions, the next step will be to appraise the accounting methods and internal control which they employ in their operations. This subject shall be considered in Chapter IV.

TABLE XXVI

YEARS OF MATURITY OF THE FINAL PRINCIPAL REPAYMENTS IN RESPECT OF LOANS GRANTED DURING THE PERIOD FROM JULY 15, 1957 TO SEPTEMBER 30, 1957

Year	Amount of Repayments	Percentage Repayments of the Total Amount of Loans Granted	Cumulative Percentage
1957	$3,170,950	36.78%	36.78%
1958	2,635,635	30.58%	67.36%
1959	1,475,621	17.12%	84.48%
1960	704,850	8.18%	92.66%
1961	275,786	3.20%	95.86%
1962 and after	203,612	2.37%	100.00%
	8,619,902	100.00%	100.00%

Source: B.C. Credit Union League, Survey Report, June 1960 (mimeographed), Vancouver, p. 46.

CHAPTER IV

ACCOUNTING SYSTEMS AND INTERNAL CONTROL

Broadly speaking, the purposes of accounting and reporting in any business enterprise are (1) to provide useful financial data for management purposes; (2) to protect the assets and other resources of the enterprise, and (3) to determine income of the enterprise for an accounting period and financial position from time to time. Accounting data to be useful must be reliable, timely and well organised and should cover the entire range of management decision. The assets and other resources to be protected include all the physical and intangible assets. Income from an accounting standpoint is generally conceived to be the residue which emerges out of the matching of expired costs against revenue. Accounting does not match cash receipts and disbursements but efforts and accomplishments, services acquired and services rendered and this can only be done by "accrual accounting." There are various accounting concepts and conventions for income determination like "costs attch", "matching costs and revenue", "income emerges", "conservatism", "accounting period", which are important but any discussion of the theoretical basis for which is beyond the scope of this thesis.

An effective system of internal control is essential for any business enterprise. Management of a credit union has the responsibility to devise and instal a system of internal control to (1) safeguard the assets; (2) check the accuracy and reliability of accounting data; (3) promote operational efficiency and (4) encourage compliance with the managerial policies. In order to achieve these objectives, the management has to provide an adequate organisational structure of a credit union; a system of authorization and recording; sound practices; and competent employees to carry out the duties assigned to them.

A credit union should have a plan of internal control laid out in writing. There should be a procedures manual outlining the accounting procedures in operation. A properly prepared manual can be a helpful guide to new employees and further provides a standard with which currently used procedures may be compared to detect departures which might lead to irregularities.

Before proceeding with the discussion of the adequacy of accounting systems and system of internal control in use in credit unions in British Columbia, it will be useful to describe the systems briefly.

I. ACCOUNTING SYSTEMS

For accounting systems in use, the credit unions may be divided into two categories: first, those which have assets of less than five hundred thousand dollars, and second, those with assets of over five hundred thousand dollars.

The first category generally adopts the standard accounting system suggested by the B.C. Credit Union League. This is a very simple system which can be understood by people with a little accounting knowledge. As the operations increase in size, this system becomes unsuitable, and more extensive bookkeeping methods have to be adopted. The division into categories is quite loose. A credit union with over five hundred thousand dollars in assets may follow the standard system, or the one with less than that amount may have an extensive system.

A. Standard System

It is a simple system mainly designed for one man operations. The following is the review of transactions that generally flow through the books of a credit union.

Cash Receipts come from deposits to current accounts against which withdrawals may be made, share capital, repayments of principal and interest on loans, interest on investments, borrowings of a credit union from the B.C. Central Credit Union or banks, admission fees, and sale of investments. Cash disbursement in a credit union is caused by withdrawals from deposit accounts, redemption of shares by members, payments of loans, purchase of investments and payment of expenses.

In small credit unions, a single copy of a deposit slip is generally prepared at the time a member makes a payment. This slip shows separately the amounts paid on account of shares, deposits, personal loans, real estate loans, endowment loans, interest and admission fees. At the end of every day, all the deposit slips are individually entered in a collections sheet, cash is debited and credits are made to shares, deposits, personal loans, etc. A synoptic Journal with control columns for cash, B.C. Central Credit Union or bank, deposits, loans, shares, and income and expense items, is used. Monthly totals from collection sheets are transmitted to the synoptic. A general ledger control account is maintained for every column of the synoptic. The details of deposits, shares, and loans of every member are kept in the member's subsidiary ledger.

Disbursements may be either by cash or by cheque. Normally in small credit unions, payments for loans to members are made by cheque. Cash payments may be made in case of withdrawal of shares or when the amount involved in a transaction is fairly small. Expenses may be paid by cash or out of a bank account, whichever is more convenient. All disbursements for expenses are to be supported by vouchers. The daily disbursements are entered in the Synoptic.

B. Other Systems

In large credit unions the operation is essentially the same, but the accounting becomes more detailed. Some credit unions, instead of entering the deposit slips in the collection sheets, run a tape of daily deposits and enter the total directly in the synoptic. There are others which even skip the synoptic and post the total daily receipts straight in the general ledger.

Some large credit unions maintain a disbursement Journal. Instead of entering daily disbursements in the synoptic, they are journalised and monthly totals entered in the general ledger. Sometimes separate member's subsidiary ledger cards are maintained for loans, shares and deposits.

A variety of accounting machines is in use in large credit unions and consequently the systems are modified to adapt to the machines. For example in credit unions where accounting machines designed to do posting operations in presence of the member are used, deposit slips or withdrawal slips are not prepared. At the time a member makes a deposit, entries are made by the machine in the member's passbook, subsidiary ledger card and daily control sheet. The entry in the passbook acts as the member's receipt for the payment he makes. Instead of preparing collection sheets and synoptic Journal, a Cash Receipts Journal is prepared which gives the disposal of the daily transactions. Postings are made from this Journal to the general ledger.

II. ADEQUACY OF ACCOUNTING SYSTEM, REPORTING, AND SYSTEM OF INTERNAL CONTROL

Since an accounting system and system of internal control are so closely interrelated, a separate discussion of each is not considered practically feasible. However, certain phases of the system of internal control will be discussed separately at a later stage of the discussion.

An approach to the problem of systems has been made from the standpoint of three major management objectives, i.e., providing suitable data for managerial decision-making, protection of assets and income determination. The writer, in order to study the systems in use, visited twelve credit unions, which comprised relatively small size operations to some of the largest in the Province.

A. Information for Managerial Decision-Making

One of the important tasks of the management of a credit union is the periodic review and appraisal of the results accomplished in its business operation. For this purpose, a balance sheet, an income statement, a report on progress of repayments on loans, an operating budget, and, if possible, a statement of source and application of funds employed, are required. The information in the statements should be effectively condensed and properly arranged.

The layout of the balance sheet and profit and loss statement generally prepared by the credit unions, is not satisfactory. The equity section of the balance sheet is not divided into liabilities and member's equity sub sections. This in particular creates confusion regarding the nature of the "reserves" which may be either liability or capital reserves. It is suggested that equity section should be classified into liabilities and member's equity. Liabilities must be further divided into current liabilities and long-term liabilities. In the member's equity sub-section, reserves, member's share capital and retained earnings should be listed separately. The present classification of the asset side of the balance sheet does not explain adequately the nature of the assets. It is suggested that assets should be classified into current assets, long-term investments, fixed assets, deferred charges and 'other assets.'

The income statement generally prepared by the credit unions lists expenses and revenue, and the difference is taken to be the net income. Such a statement does not disclose the extent of margin for various classes of expenses and claims which can be very useful for managerial purposes. The following layout of the income statement is suggested.

Income Statement
for the Year ended December 31, 19__

Income		
Loan Interest	________	
Bond Interest	________	
B.C. Central Interest	________	
Endowment Income	________	
Chequing Service Income	________	
		________
Operating Expenses		
Interest on member's deposit accounts	________	
Interest on borrowings	________	
Bond Premium written off	________	

B.C. Central or Bank Service Charges		
Gross Operating Income		
Administrative and General Expenses		
Salaries		
Rent, Light, Heat		
Office Supplies		
Insurance		
League Dues		
Depreciation Expense		
General Expense		
Income on operations		
Other income		
Cuna Mutual Dividends		
Entrance fees		
Net Income		

It may be remarked that this is not an all inclusive income statement. More items can be added depending on the requirements of a credit union.

The existing methods of reporting in the credit unions in British Columbia do not provide the management with any information regarding closing of accounts or opening of new accounts. It is suggested that a monthly list be prepared of new accounts and of members who closed their accounts. Copies of this list should be submitted to the board of directors and the Supervisory Committee. This list will indicate the effectiveness of efforts to encourage potential members to join the credit union. It will also disclose whether a special investigation should be made as to the reasons why members are closing their accounts.

Another report that can be useful for managerial purposes, is a condensed statement on the progress of repayments on loans. In the present system, management of a credit union has to look up members' subsidiary ledger cards to examine the repayments and follow-up on loans outstanding. It is suggested that small credit unions should use a loan register with columns for name of the borrower, kind of security taken, amount of loan, rate of interest, all dates of repayment according to the agreement, and for remarks. There should be two sub columns under each column for date of repayment, one for principal and the other for interest. This register will not only be useful to the board of directors and the supervisory committee but also to the treasurer who will get timely information for follow-up of overdue instalments. This register is in fact a summary of the loan section of the members' subsidiary ledger. At the end of the month, the total of loans receivable according to the register should be compared with the general ledger control account. The loan register may not, however, be adequate for large credit unions and for them some other reporting system can be devised.

Very few credit unions in British Columbia prepare an operating budget for the next year. Equally important with the review of the current and the past results of operations is an estimate for the results for future operations. Only by budgeting the income and expenditures, can the board of directors arrive at a sound businesslike basis for direction and control. The budget can easily be drawn from the past one or two years experience of the credit union. After the end of the budget year, the actual data should be compared with budget and variances analysed. It is suggested that an operating budget should be drawn up by every credit union.

Apart from the operating budget, a flow of cash budget should be prepared in the beginning of the year. The feasibility of such a budget has already been discussed in Chapter II. At the end of the financial year, if possible, a source and application of funds statement may be prepared. This can prove useful to the management for analysing the causes of the changes in the working capital during the year. Such a statement will only be feasible in large credit unions.

B. Protection of Assets

A variety of protective devices are in use in credit unions. These include locked cash drawers, safes, vaults and the services of banks, among others. Such devices provide protection against accidental hazards and unauthorized transactions. The assets generally protected through these devices are investment securities, borrower's securities and other valuable records. Another protective device used by some credit unions is insurance against physical dangers to the valuable assets.

According to Rule 46, the treasurer is responsible for the safe custody of securities and other valuables.[1] For

[1] Credit Unions Act, R.S. 1948, c. 82, Constitution and Rules, R. 46.

better internal control, it is suggested that the large credit unions should make two officials responsible for the custody of securities. All employees of the credit unions handling cash and securities are properly bonded.

C. Determination of Income

The management must review the profitability of the credit union operation. For this purpose, an accurate and properly drawn up income statement is essential. The correct determination of income of credit unions in British Columbia is not possible, because the main item of income, viz., interest, is normally not accrued.

> Only twenty-one credit unions out of some three hundred and twenty-six accrue interest in their books; here each month interest income is credited with the amount earned even though it has not been received--the charge is to accrued interest receivable and when the interest is finally received, the credit is made to accrued interest receivable account....The large majority do not accrue interest but credit income only as loan repayments are received.[2]

One of the cardinal principles of accounting is matching costs against related revenues; accrual and deferment are closely related phases of the process of matching. It is essential for the correct statement of income that income accrued but as yet uncollected should be recognised. If accrued income is ignored, services rendered by the credit union will be incorrectly expressed.

Since a credit union under Rule 46 has to prepare

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[2]B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, p. 53.

a monthly statement showing the condition of the credit union as at the close of the month, it is essential that interest income be accrued every month. Certain credit union officials object to accruing interest income on the grounds that there is a possibility of an unjustifiably high declaration of dividends because of the inclusion in the figure of net annual earnings, an amount of accrued interest. This may be true in certain cases, but it is not a valid reason for misstatement of income. It is the duty of the B.C. Credit Union League to educate the credit unions to appreciate and understand their financial condition and avoid an unjustified declaration of dividends.

There is another aspect of credit union income determination that needs consideration. Bad debt expense which is a valid operating expense is not taken into account while determining the income. Any comparison of income between one credit union and another and between a credit union and some other lending institution is impossible because of this omission. The responsibility for the omission can largely be attributed to the B.C. Credit Unions Act[3] which requires 20 per cent of the annual earnings to be set aside in reserve fund to take care of the losses on bad loans and investments. This precludes the necessity of estimating losses on bad loans and consequently charging bad debt expense against the income. The feasibility of a supplementary income statement which

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[3]Credit Unions Act, R.S. 1948, c. 82, s. 34.

would take bad debt expense into account, is debatable. Probably some large credit unions can afford to prepare such a statement.

III. FURTHER EVALUATION OF INTERNAL CONTROL

In this section, the effectiveness of internal control will be studied in respect of cash receipts, cash disbursements, confirmation of loans receivable, control of delinquent loans, and the record procedures.

1. Cash receipts and cash on hand

Rule 27 provides that

> All payments made by or to a member shall be evidenced by a passbook, which shall contain separate columns for recording payments made by or to the member. Every entry in the passbook shall be initialled by the treasurer or other officer receiving or paying out the money, and no money shall be received from, or paid to, a member unless the passbook is presented and proper entry made therein.[4]

This rule has been considerably contravened by the credit unions. Admittedly, it is a hard provision to observe, but on the other hand it has many advantages--it acts as a receipt for payments and withdrawals, and is evidence of the balance outstanding. Further, it is a sound practice, ensuring the integrity in recording the transaction in credit union books. Generally, in the absence of the passbook,

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[4]*Credit Unions Act*, R.S. 1948, c. 82, Constitution and Rules, Rule 27.

credit unions prepare deposit slips in duplicate, and a copy is given to the member as a receipt.

In some small credit unions, it has been found that irrespective of the presentation of the passbook by the member, a single copy of the deposit slip is prepared which is kept by the credit union itself. The member has no proof of having made the payment. Certain treasurers of small credit unions sometimes receive payments from members outside the office without issuing any receipt.[5] This is a very dangerous practice. The treasurer may forget to record proper entries in the books, or even if he does not forget, the money in his pocket provides an extra inducement for dishonest practices.

Deposit slips should be prenumbered and prepared in duplicate at all times irrespective of presentation of passbook. The teller should be made responsible to account for all the slips. In cases of credit unions with more than one teller, the deposit slips with different number series may be used. Such a system will ensure against destruction of deposit slips and manipulation of cash.

Postings to the synoptic of collection sheet totals and of other transactions should be carried out regularly. In certain small credit unions posting is behind as far as two months. Posting to members' subsidiary ledger for deposits

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[5]Mr. J.F. Quail, Field Representative, B.C. Credit Union League, Personal interview September 15, 1960.

and withdrawals is also delayed in certain cases. Because of the nature of operation of credit unions, the accounting work must be up-to-date at all times. Any delay in posting in deposit and share accounts may result in allowing withdrawals in excess of credit in the account and lead to overdrafts. All the large credit unions visited by the writer were quite up-to-date in postings.

A case came to the notice of the writer where cash had not been reconciled for an unreasonably long period of time and members' subsidiary ledger was out of balance with the control account. This is a serious irregularity. Cash should be reconciled daily. In small credit unions where the number of transactions in a day is quite small, reconciliation may be carried out once a week. Wherever possible, reconciliation should be carried out by a person other than the teller who received cash.

Credit unions are required by law to prepare a bank reconciliation at least quarterly. Some large credit unions find it a cumbersome provision because reconciliation of millions of dollars requires great amount of effort and expense. They are of the opinion that the Inspector of Credit Unions may be empowered to decide the requirement of bank reconciliation on the performance of a credit union. This does not seem to be a sound suggestion. A quarterly financial statement has to be submitted by every credit union to the Inspector of Credit Unions. If a bank reconciliation is not carried out, there is a likelihood of mis-statement of balance sheet accounts. Going a little further, a bank reconciliation should be carried out monthly for correct presentation of the condition of the credit union in the month end statement required under Rule 46.[6]

If a front office bookkeeping machine is used, it must be ensured that access to the machine proof sheet is limited to the treasurer, office manager or supervisory committee who do no cashiering. The tellers should not be allowed to balance share and loan accounts with general ledger controls and they should not have access to the cash records. Further, the tellers should not be allowed to prepare deposits to banks or to receive bank statements. The tellers, if assigned to specific blocks of accounts, must be rotated from time to time.

2. Disbursements

Rule 44 requires the President to sign all cheques, notes, drafts and other negotiable instruments on behalf of the credit union. According to Rule 46, the treasurer shall countersign all these documents.[7] In practice, it is found that the cheques are sometimes signed in blank by the President. Though this practice is against the law and contrary to the recognised principle of internal control that requires a system of authorisation adequate to provide reasonable accounting over assets, liabilities, revenues and

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[6] Credit Unions Act, R.S. 1948, c. 82, Constitution and Rules, Rule 46.

[7] Ibid., Rules 44 and 46.

expenses, it should be admitted that it is rather onerous for the President who receives no remuneration, to come down to the credit union office every day to sign the cheques. The Survey Report, reviewing this question stated:

> However, the reason for this is a most dangerous practice--67.2% answered Q. 140 in the affirmative, i.e., the President or Vice-President signs blank cheques, etc.[8]

Going further, the Survey Report made certain recommendations to modify this provision:

> We suggest that credit unions having a full time treasurer and one other employee should be free to name any two officers and/or employees or alternates who may sign cheques, notes, etc., provided this provision is contained in the rules of such credit union. Rule 44 would therefore be prescribed for a limited group of credit unions of smaller size.[9]

It may be remarked here that the Constitution and Rules given under the Credit Unions Act can be amended by a credit union with the approval of the Inspector.

It is fairly common among large credit unions for cheques that have been signed by the treasurer to be handed to an assistant in the office for mailing. This is a weakness in internal control; the cheques should be mailed by the treasurer himself.

It has been observed that some credit unions do not prenumber the cheques. The sound practices of internal control require the cheques to be prenumbered and all numbers accounted

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[8]B.C. Credit Union League, Survey Report June 1960, (mimeographed), Vancouver, p. 114.

[9]Loc. cit.

for. All spoiled or voided cheques should be retained for audit purposes.

Certain cases have been noticed where paid invoices are not cancelled and sometimes double payments are made.[10] The invoices and bills for credit union expenses should be marked "Paid" with the date of payment in ink or by stamp to prevent their being used more than once to support a disbursement.

3. Confirmation of Loans Receivable

Under the Rules, the supervisory committee must cause all the members' account balances to be confirmed at least once a year.[11] All benefit of confirmation procedure is lost if the supervisory committee loses control over the confirmations.

The B.C. Credit Union Survey Report indicates that in about forty per cent of cases the supervisory committees lose all control over the confirmations and the letters are mailed by the treasurers. About thirty per cent of the credit unions request the members to report differences directly to the treasurer or to the credit union.[12] The supervisory committee must compare the amounts in confirmation letters with members' ledger accounts and the letters should be kept in its custody until they are mailed. The addresses

[10] Mr. J.F. Quail, Field Representative, B.C. Credit Union League, Personal interview Spetember 15, 1960.

[11] Credit Unions Act, R.S. 1948, c. 82, Constitution and Rules, R. 61.

[12] B.C. Credit Union League, Survey Report, June 1960, (mimeographed), Vancouver, pp. 23-24.

on the envelopes should be checked with those given in membership applications. The replies to the confirmations must be addressed to the supervisory committee at some private address. The treasurer or his staff should in no case have any access to the confirmations or have any part in selection of accounts for confirmation or the mailing of confirmation or handling of returns from members. The confirmation may be carried out at one time or in batches so that by the end of the year, all accounts have been confirmed at least once.

4. Control of delinquency, charge-off of loans

Almost all credit unions present monthly reports on delinquent loans to the boards of directors. The boards generally issue directions to the treasurer regarding the follow-up of these loans. In some credit unions, the boards refer delinquencies to Delinquent Loan Committees for further action.[13] In cases where repayments on a loan are excused or the terms of the original agreement are modified, a memorandum outlining the new terms should be prepared. This is done by a large majority of the credit unions but there are some which fail to make any record of the amended agreement.[14] This is a serious omission and proper records should be maintained.

All charge-off of loans should be decided by the board of directors and the decisions recorded in the Minutes specifying each case individually. The mechanics of controlling accounts in arrears or delinquency differ from one credit union

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[13] *Survey Report*, *op. cit.*, pp. 4 and 9.

[14] *Ibid.*, p. 14.

to another, and include such systems as:

(a) the affixing of tags or "flags" to the ledger card with different colours denoting the degree of delinquency or action taken;

(b) full segregation into boxes appropriately marked, of all cards in arrears, with sections (or degree, or action taken);

(c) the use of a combination desk calendar pad marked with the numbers of the payments due on each particular day with spaces for ticking when payment received;

(d) letters from the treasurers, supervisory committees, delinquency committees and/or boards of directors to the members at various stages of arrears or delinquency;

(e) a 'personal approach' system to be combined with, or follow-after the 'wait' system. This could also include telephone contacts;

(f) in a very few cases, different coloured cards are used to denote extremely delinquent accounts, but this system is neither effective nor efficient.

5. Record Procedures

The classification of data within the structure of accounts has not been properly done in certain credit unions. For example, office supplies and office equipment are put together in one account. The accounts should be laid out in such a way that the assets and liabilities and the revenues, costs and expenses are sufficiently broken down to be useful to the management in its control of operations.

It was observed in one credit union that "convention expense" which is an expense item was set up as an asset in the accounts.

It is suggested that B.C. Credit Union League should prepare a standard chart of accounts which is provided to all the credit unions. This chart should meet the following requirements:

(a) State clearly and accurately what should be contained in each account;

(b) Demarcate clearly the boundary lines between capital assets, and expense items;

(c) Give clear account titles and an adequate numbering of accounts;

(d) Provide control accounts where necessary;

(e) Facilitate economical preparation of reports and financial statements.

6. Miscellaneous

Some credit unions do not adopt any regular system of amortization of assets. Overstatement of assets has been observed in some credit unions which do not depreciate equipment, furnishings and fail to amortize prepaid expenses. Due to this irregularity there cannot be proper matching of costs against revenues and consequently income is overstated.

Certain cases have been observed by the writer where entries in the ledgers are made in pencil and an unreasonable number of corrections are made which completely obliterate the figures. All records of credit unions should be maintained in ink or typed by accounting machines. Corrections should be made in such a manner that the change can later be verified.

Most of the irregularities committed in the credit unions can be avoided if the supervisory committee performs its duties up to the standards set under the B.C. Credit Unions Act.

IV. RESPONSIBILITIES OF A SUPERVISORY COMMITTEE

The supervisory committee must, itself, make or without detracting from its own responsibilities, cause it to be made by a chartered accountant or other person approved by the Inspector, at least an annual audit of the accounts of credit union. It shall make a report to the members on the condition of the credit union found as a result of this audit, and on every balance sheet laid before the credit union in general meeting during the tenure of office. The report must state:

(a) whether or not the committee has obtained all the information and explanations it has required; and

(b) whether in its opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the credit union's affairs according to the best of its information and the explanation given to it, and as shown by the books of the credit union.[15]

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[15] Credit Unions Act, R.S. 1948, c. 82, s. 29.

Hall and Loffmark, viewing the nature of the audit required, state:

> It would appear that by section 29 of the Credit Unions Act there is imposed on the supervisory committee a duty to perform an audit similar in scope to that mentioned in section 152 of the Companies Act (British Columbia). An audit of the balance sheet and the accounts of a credit union may be defined as an examination of the records of the credit union sufficiently comprehensive as to justify the expression of an opinion by the supervisory committee and the making of a report by them to the members on the accounts examined by them and on the balance sheet. It should be emphasized that the opinion upon the accounts and a balance sheet is given only after an examination of such a nature and scope as will justify the expression of such an opinion.[16]

It should be pointed out that an audit by a chartered accountant or other person approved by the Inspector of Credit Unions does not in any way lessen the responsibilities of the supervisory committee.

Apart from the annual audit, section 29(2) and Rule 58 require the supervisory committee to make an examination of the affairs of the credit union and audit its accounts at least quarterly. It is also required to submit a written report in duplicate within thirty days of this examination to the Inspector. A copy of the case reconciliation report has also to be submitted along with this report.[17]

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[16] Hall and Loffmark, British Columbia Corporation Manual, Richard De Boo Limited, 137 Wellington St. West, Toronto, Canada, 1957, p. 1014.

[17] Credit Unions Act, R.S. 1948, c. 82, s. 29(2), and Constitution and Rules, Rule 58.

A brief discussion of a few recent cases of misappropriation of funds, will bring forth the importance of the supervisory committee and the consequences that can ensue if it neglects its duties.

V. RECENT CASES OF MISAPPROPRIATION OF FUNDS IN CREDIT UNIONS

All reported cases of misappropriation occurred in large credit unions. It is quite interesting to note that in spite of untrained management and loose controls in certain small credit unions, there has been practically no case of misappropriation of funds in the history of small credit unions of this Province.[18]

Lapping has been reported as the method of misappropriation in one case. The cheques for payroll deductions were received every month. The treasurer had a cheque cashed and pocketed the money. He did not enter the cash receipt in the books. The cheque for the subsequent month was adjusted towards the payment for the previous month and this practice was carried on for more than a year. The supervisory committee could have discovered the lapping had it confirmed the member's account balances. In another case, where a substantial sum of money was involved , the treasurer started taking money out of the till and stopped

[18]Mr. J.F. Quail, Field Representative, B.C. Credit Union League, Personal interview, September 15, 1960.

making a daily cash reconciliation. Going further, he started forging the signatures of the members on the withdrawal slips, and issued cheques in members' names and then cashed them within the credit union office after making forged endorsements. This was a case of gross disregard of internal control principles and sloppiness on the part of the supervisory committee. This credit union was a two-man operation. Presumably the complete handling of cash transaction was done by the treasurer himself; otherwise the removal of cash would have been detected by one of the other employees. In order to conceal the misappropriation, the treasurer made certain adjustments, and raised the balance in the suspense account to more than $10,000. The supervisory committee did not investigate the causes for such a large balance, and further, ignored the failure to reconcile the cash daily. In another case of misappropriation, the teller would destroy the deposit slips and pocket the money. She, however, made correct entries in the members' subsidiary ledger. The general ledger control account was out of balance with the total of the subsidiary accounts. It was a long time before this discrepancy was detected, the reason being that the supervisory committee did not regularly compare the balance in the control account with the total of the subsidiary ledger. In this case also the balance in the suspense account was enormous, but the supervisory committee failed to investigate its causes.

The "League" should initiate an education programme which makes the supervisory committee realise its statutory obligations. It is suggested that the "League" should require each supervisory committee to submit a report at the time of each inspection or audit, stating various tests and procedures carried out and the results obtained. Preferably a printed proforma check list outlining the procedures might be supplied to the credit unions.

Basic accounting knowledge is essential for the treasurers to perform their duties properly and efficiently. It is therefore suggested that all unqualified treasurers be required by law to take at least one basic course in accounting. For new treasurers, this course should be a prerequisite for holding the post as such.

With this evaluation of credit union systems and internal controls, we come to the conclusions which will be considered in the following chapter.

CHAPTER V

CONCLUSIONS

One hundred and ninety-four thousand wage earners in the Province of British Columbia have invested more than seventy-eight million dollars in credit union shares. These people have successfully ventured to solve the intricate problems of consumer credit in a cooperative way. Not only were their credit problems solved, but they learned how to stand on their own feet in a true democratic set up. In rendering cooperative service to their membership, the credit unions have proved the saying of Desjardins, "The people's welfare can best be secured by institutions organized by the people themselves."[1]

The spectacular growth trends as depicted by tables in Chapter I and projection charts in Chapter II might give an impression that credit unions in a couple of decades will displace some of the competitive lending institutions. An over-enthusiastic credit union man might make a statement to the effect that credit unions someday will supply all the credit and thrift needs of the masses. This is most unlikely and also undesirable. There is a basic truth in the findings of the Royal Commission on Cooperatives in 1945:

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[1]Roy F. Bergengren, Credit Union North America, Southern Publishers, Inc., New York, 1940, p. 1.

> We are also satisfied that credit unions are not displacing any other type of business enterprise, except to provide an alternative source of loans in a field where individual money lenders or lending institutions do not provide similar credit facilities at comparable net rates.[2]

The credit unions have many legal restrictions--they must be confined to groups of people who have a common bond of occupation or association or form an identifiable segment within a community in a certain neighbourhood or rural or urban district; there is a limit on the amount of unsecured loan a credit union can grant; further primary emphasis is laid on the service to the individuals and excludes business enterprises.

In spite of all these limitations credit unions have a large potential for growth. This potential mainly lies within organizations and communities where individuals have a common bond of interest. Though Chart A exhibits that the growth of savings, loans and membership in credit unions is at a declining rate, nevertheless they are showing better performance in instalment lending than any other instalment lending institution in the market, (Table I).

Credit unions have done very little advertising to promote their business. In modern economic systems, advertising is an indispensable media to promote an idealogy. In the past, credit unions seem to have capitalized upon the potential field of cooperative minded people. This field is more

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[2] Report of the Royal Commission on Cooperatives, King's Printer, 1945, p. 52.

or less limited and now the credit unions in order to expand their business, will have to educate the people to their philosophy and the benefits of borrowing from them. This can be done only by perpetual advertising campaigns by the B.C. Credit Union League.

Much of modern consumption theory is applicable to credit unions. However, it should be kept in mind that this is not a perfect theory. Certain fundamental questions of consumer motivation for saving and dissaving are not adequately answered by it. In credit unions, it would seem that people save not for investment but for future consumption, either for purchase of durable goods or for a "rainy day".

Credit unions have a good record of collection of loans. As at December 31, 1958, 1.05% of total loans outstanding were estimated to be uncollectible. The percentage of total bad debts since incorporation to total loans since incorporation was .382. Some credit unions show a very low loss ratio. A low loss ratio is not essentially a measure of good management. This may be secured by following a conservative policy or adopting an excessively stringent collection attitude. The statutory reserve fund has been adequately provided for. The percentage of reserve fund to total loans outstanding is 3.4 which more than adequately takes care of the estimated bad loans, i.e., 1.05%.

The statutory reserve fund according to the B.C. Credit Unions Act is required to be used only for paying losses of the credit union arising from bad loans or investments. It seems that reserve and liquidity have been confused in this Act. When a loss on bad loans or investments occurs, a reserve is required to absorb the loss; it cannot be paid for out of cash, consequently there is no need to keep the reserve in liquid form. The intent of this Act will be far more understandable to the credit unions if the requirements as to allowance for bad debts and liquidity are separately stated. Further, it would be more logical to base the requirement for reserves upon a relationship to loans outstanding rather than share capital as is required by the Act now.

Liquidity is another measure of financial soundness. The credit unions in British Columbia have a good record of liquidity. As at December 31, 1958, total funds retained by credit unions were larger than the legal requirements. (Table VII). In larger groups of credit unions, the percentage excess of funds to requirements is lower than that in smaller groups. This may mean that the management of a large credit union is more conscious of the overall profitability of the business.

Though the credit unions can maintain liquidity during normal times it might become a significant problem in a recession if repayments of loans were not regularly made and savings declined while, at the same time, there was a heavy demand for withdrawals. Such a situation might reduce cash funds below the statutory minimum. If credit unions continued to make loans in these circumstances, liquidity would be considerably impaired. A credit union should stop making new loans until its cash funds are restored to the minimum amount required under the Act.

Another factor in liquidity is seasonal demand for withdrawals from credit unions. There is generally a heavy demand for withdrawals during the period starting from May and extending to September or October (Tables X and XI). Liquidity is also affected by long-term loans. There is a rising trend towards real estate loans which are generally long-term. If this trend continues on for some time, there will be a need for higher amounts of cash reserves.

Considering the lending practices of credit unions, it seems that the major portion of lending is done for the purposes of purchasing durables and real estate. Convenience credit and emergency credit constitute only 18% and 13% of total lending respectively. In smaller credit unions where the funds available are relatively small, loans for household equipment, consolidation of funds and other similar purposes predominate. On the other hand, in larger credit unions quite a large percentage of loans are made for real estate, home improvements and the purchase of durables.

More than one-half of the number of loans and one-quarter of the total amount of loans are made with only signatures and shares as security. The security of real estate is quite popular, accounting for 33% of the total amount loaned and 12% of the total number of loans. In small credit unions, tangible security like chattel mortgages and real estate constitute security for a small part of the volume of loans whereas intangible securities like comaker and shares in the credit union predominate. The situation is the other way around in large credit unions. The demand for small loans is being met by all credit unions but in large credit unions enough funds are available for real estate and other large loans.

Quite a number of credit unions do not comply with the legal requirements in taking loan securities. In many cases chattel mortgages on automobiles and household effects are not registered. The management of credit unions has to be educated to the consequences of these omissions. It is desirable that the insurance policies on real estate and automobiles are endorsed payable to the credit union at the time security is taken. About 60% of real estate loans are granted without an appraisal of property. Though, in some of these cases, the credit union officials may be familiar with the property and consequently there may be no need for appraisal, yet in others, it is very essential that a proper appraisal is made.

The rates of interest charged on loans vary from one credit union to another. At the end of the year, a large percentage of credit unions make interest refunds to borrowers. The net charge of credit unions on loans is most reasonable as compared with other lending institutions.

Loans are kept on a reasonably short-term basis. Bearing in mind that 33% of loans are real estate loans, the fact that 85% of the total loans (Table XXV) are repayable within twenty-seven months, indicates a reasonably short-term for loans.

The accounting systems in use, though reasonably satisfactory, are generally not used properly in a large number of small credit unions. The standard methods of internal control used in mercantile corporations cannot all be applied to small credit unions. A small credit union is usually a one-man operation and a division of functions is not possible. Most of the responsibility for proper control of the operations of a credit union lie with the supervisory committee.

The supervisory committee, for proper supervision of the progress of loans, requires ready information about their maturity dates. For this purpose the use of a loan register has been suggested. Such a register will give a comprehensive picture of repayments and the follow-up of loans.

There are certain phases of internal control which could be made applicable to credit unions but are sometimes not applied. For example, sound practices like, prenumbering of deposit slips, cheques, and proper accountability for all the numbers; giving a receipt to the member at the time of payment of money to the credit union; requiring the signatures of two responsible persons on cheques; cancelling the documents of original entry like invoices and bills when the payment is made on them, can easily be brought into use. Wherever possible, the methods of internal control should be enforced.

It is felt that the management of a credit union does not use some of the important accounting tools for proper direction and control of its affairs. For that, the preparation of operating budget and cash flow budget is suggested. Also, the large credit unions should prepare a statement of source and application of funds.

The supervisory committees in small credit unions are not discharging their duties properly. It is felt that in some cases, the members of this committee are completely ignorant of their obligations under the B.C. Credit Unions Act. It is the duty of the "League" to educate the credit union officials about their duties and the methods to discharge those duties. It is suggested that the "League" should require each supervisory committee to submit a report to it at the time of every inspection stating various procedures and tests carried out and the results obtained. Some treasurers show gross ignorance and disregard of accounting methods. It will be highly useful to the credit union movement if all the treasurers are required by law to take at least a basic course in accounting.

The overall financial health of credit unions in British

Columbia is satisfactory but the back bone of financial operations--accounting systems and internal control require serious consideration. The credit unions of this Province have a secure and prosperous future, and it is hoped that more and more wage earners will benefit from this unique credit union philosophy.

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Appendix 1

Percentage Distribution of Loans by Purpose
Main Branch of a Large Bank
in Vancouver

Medical Expenses	7%
Consolidation of Debts	7%
Taxes, Mortgages, and Insurance	11%
Education	5%
Travel and Vacation	12%
Purchase of automobiles	24%
Household furnishings and appliances	4%
Miscellaneous	30%

Source: Personal interview.

Percentage Distribution of Loans by Purpose
Consumer Finance Company in Canada
(Name not disclosed)

Remedial and Emergency		
Consolidation of existing debts and medical expense		52.9%
Current and Miscellaneous		
Repairs	6.2%	
Assisting relatives	2.5%	
Clothing, food, rent, etc.	5.2%	
Taxes	4.3%	
Moving expense	.8%	
Miscellaneous	9.2%	28.2%
Investment and Health Advancement		
Automobile	5.4%	
Investments	2.3%	
Furniture	1.9%	
Insurance	1.3%	
Mortgage and interest	.2%	
Travel and vacation	7.2%	
Education	.6%	18.9%
		100.0%

Source: C.M. Benadom "Consumer Finance Companies" appeared in Credits and Collections in Canada, 1958, The Ryerson Press, Toronto.