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## Disciplining building societies by accounting-based regulation, circa 1960



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Taking as its point of departure the rules regulating accounting practice, this article focuses on the use of accounting numbers and ratios to regulate the specific behaviour of reporting entities. In particular, the corporatist analysis provides a framework for exploring the use of accounting-based regulation to discipline those depository financial institutions that depart from industry norms. Empirical support built upon the legislation enacted in 1959 and 1960 which set performance parameters for building societies and gave the Chief Registrar of Friendly Societies new powers of intervention. These powers and parameters were used together with accounting ratios (which were generally recognised as financially sound within the industry) to discipline building societies. Although only a tiny fraction of the societies were ultimately sanctioned, they all acknowledged important deviations from specified accounting-based criteria. In some cases accounting-based criteria were effective in driving societies to dissolution, while others, which avoided immediate dissolution were forced to improve their governance and systems of internal control. Intervention was further activated under the interdependent relationship formed between the Registrar of Friendly Societies and the Building Societies Association. Together they successfully lobbied state authorities to discipline societies outside the industry association. As a result, the evidence documented in this paper sheds light on the dynamics upon which accounting-based regulation came to be constructed and implemented.

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### 1. Introduction

For most of the 20th century depository financial institutions in the UK were subject to strict control by the state, as seen in the introduction of statutory minimum capital requirements and/or deposit insurance schemes. More recently and on the back of the post-2007 financial crisis, accounting numbers (including reserve ratios) have been judged highly relevant in the attempts to implement regulatory reform via the so-called Basel III global regulatory standard.

Whether resulting from compulsory regulation or corporate governance, adequate internal control is necessary not only to prevent misappropriations (e.g., Bátiz-Lazo & Billings, 2012a; Noguchi & Bátiz-Lazo, 2010) but also, as cases of rogue traders at Barings, Société Générale, JP Morgan and UBS have shown, to curb undesirable risk-taking. However, in certain forms of depository financial institutions it is still not clear how intervention by regulatory authorities leads to changes in the systems

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for accounting control. The evidence in this study offers answers to this question by documenting how accounting information was instrumental for two state authorities, namely, HM Treasury and the Chief Registrar of Friendly Societies (CRFS),<sup>1</sup> to discipline the behaviour of a group of building societies.

Building societies were first established in the late eighteenth century to enable working class and lower-middle class people to purchase or build their homes. By 1960 the powers and duties of the CRFS had gradually expanded to cover the entire life of a society.<sup>2</sup> Research in this article will focus on the powers and attributes of the CRFS which relate to 'accounting-based regulation', that is, the set of codified practices, enshrined in law, in which financial or accounting data provide underlying criteria for identifying a regulatory space or a set of subjects to be regulated. *Chen and Wang (2007)*, *Chen and Yuan (2004)*, *Lapsley and Llewellyn (1991)* and *Miranti (1990)* are all notable exemplars of systematic studies on accounting-based regulation. *Sikka and Willmott (1995)*, *Tinker (1985)*, and *Watts and Zimmerman (1986)* provide important insights into the rules and the regulation of accounting practice and the systems built upon them to secure compliance with these rules. However, the focus of the research in this paper is the analysis of the specific accounting numbers and ratios for regulating behaviour which departs from industry norms, giving details of the way in which such regulation came to be constructed. Specifically, this study builds on the analytical framework derive from corporatist theory to examine the process through which accounting-based regulation was introduced and implemented with the enactment of the House Purchase and Housing Act, 1959 (HPHA59) and the Building Societies Act, 1960 (BSA60).<sup>3</sup>

The rest of this study proceeds as follows: to clarify what is meant by a corporatist framework and what it implies as a tool for analysing the relationship between state authority and organized interests, the next section describes the relevant features of the corporatist analysis. The section after this offers a brief history of building societies. It examines the process of establishing HPHA59 and BSA60 with an emphasis on the introduction of accounting-based regulation and the extended powers of the CRFS. The fourth section examines individual cases of regulatory intervention by the CRFS through the disciplinary powers recognized under BSA60. The cases selected in this section are those for which detailed information was readily available. The final section discusses the findings and draws some conclusions.

Before proceeding, note that accounting-based regulation could have been used to discipline the behaviour for other British institutions that the regulatory authorities were also concerned within this period, notably the trustee savings banks (through the National Debt Commissioners) and insurance companies (through returns to the Board of Trade). Like the building societies, both of these were large in numbers. Hence, accounting-based regulation was not a unique remit of building societies; but it is outside the scope of this paper to ascertain its full implications in post-war Britain.

## 2. Corporatism

According to *Williamson (1989: 223–224)*, '[c]orporatism is concerned to restructure the relationship between producers, producer associations and the state to significantly shift the balance of influence in negotiations over intervention into production in favour of the state'. This basic idea has found empirical support in a number of systematic studies applying the analytical framework of corporatism to the construction of accounting regulation in a particular country. These include studies by *Willmott (1985)*, *Richardson (1989)*, *Willmott, Puxty, Robson, Cooper, and Lowe (1992)*, *Chua and Poullaos (1993)*, *Walker and Shackleton (1995, 1998)*, *Stoddart (2000)*, *Rodrigues, Gomes, and Craig (2003)*, *Noguchi and Edwards (2004)*, *Noguchi (2005)*, *Abeysekera (2005, 2006)*, *Noguchi and Bátiz-Lazo (2010)* and *Rodrigues, Schmidt, Dos Santos, and Dutra Fonseca (2011)*.

Under corporatism, the state is seen as an organizationally powerful entity able to pursue its own institutional interests through its size, complexity and bureaucratic power.<sup>4</sup> Such interests are embodied in an institutional logic made up of legal rules, explicit norms and implicit premises. This conception makes possible the exploration of a range of relationships between the state authority and organized interests because these relationships are not all the same (*Cawson, 1983: 179*). For instance, if the behaviour of other organized interests challenges the interests of the state, the state will change its behaviour

<sup>1</sup> The origin of this department goes back to the establishment of the Registry of Friendly Societies in 1846. The original function was to certify the rules of a society before it was established. Section 3 of the Benefit Building Societies Act 1836 required building societies to register their rules; and Section 3 of the Building Societies Act 1874 brought this register under the aegis of the Registry of Friendly Societies. The Friendly Societies Act 1875 established the Central Office of the Registry of Friendly Societies, consisting of a Chief and Assistant Registrars. The Chief Registrar had to 'be a person of experience and with appropriate qualifications' (FS23/289, draft submission to the Economic Secretary by the Home Affairs Committee). To be appointed the Chief Registrar, the candidate had to be a barrister of not less than twelve years' standing, and at least one year's experience as Assistant Registrar.

<sup>2</sup> These included the examination of the proposed rules of any society applying for registration (Sections 9 and 10 of the Building Societies Act 1874); the authorization of any amendment in its rules (Section 18 of the 1874 Act); the certification of the termination of a society by dissolution (Section 7 of the 1894 Act); the approval of amalgamation or a transfer of engagements (Section 56 of the 1960 Act); and the power to cancel the registration of a society (Section 6 of the 1894 Act).

<sup>3</sup> Reference to BSA60 is often substituted by the reference to the Building Societies Act, 1962 (BSA62) because BSA62 consolidated all the relevant legislation between 1874 and 1960.

<sup>4</sup> It is however argued that 'the treatment of the state under corporatism has been guilty of reification – attributing motives and interests to a thing rather than individuals – and presenting it as a monolithic entity with a single purpose' (*Williamson, 1989: 120*). Furthermore, despite the importance attached to the state, it is recognised that 'there has been a failure to develop a satisfactory theory of the state': 'the absence of a satisfactory link between a macro-theory of the nature of the state and state power, and theoretical propositions regarding state behaviour that can be employed and tested in empirical analysis' (*Williamson, 1989: 120*).

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