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1956-1960**

by

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## **Reforming the Form of the Auditors' Report: The Case of Building Societies, 1956-1960**

### **Abstract**

The purpose of this study is to explore how the audit of building societies changed in the late 1950s in a reversion of audit objective from 'fraud detection' to 'statement verification' (Chandler *et al.*, 1993: 452). Of particular interest is the analysis of the extended negotiations between the ICAEW and the Treasury over the reform of the form of the auditors' report for building societies, which was implemented through the enactment of the Building Societies Act 1960 (BSA60). We show how change implemented through the BSA60 relieved chartered accountants from 'out of tune' (T233/1652) practice established by nineteenth century legislation, but to do so required them to take an alternative duty to report on internal control.

**Keywords:** building societies; the form of the auditors' report; the auditors' reporting duty on internal control; the ICAEW; Building Societies Act 1960 (BSA60)

### **Introduction**

Section 404 of the Sarbanes-Oxley Act, enacted on July 30<sup>th</sup> 2002, required each firm listed in the USA to issue an 'internal control report which shall...contain an assessment...of the effectiveness of the internal control structure and procedures of the issuer for financial reporting' (Coustan *et al.*, 2004: 43). The section requires the auditors attesting and reporting on the management's internal control assessment. According to a partner of a 'Big 4' firm, 'The consideration of internal controls has been a tool used in planning the audit, but now internal controls will be an objective of the audit' (cited in Coustan *et al.*, 2004: 44).

On the other side of the Atlantic, all listed companies in the UK were required, under the Listing Rules 9.8.6.(5), to report on how they had applied Section 1 of *the Combined Code on Corporate Governance* (revised in June 2006) in the annual report and accounts. Principle C.2 of the Code stipulates that 'The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets' and Provision C.2.1 'The directors should...conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems'. The report and accounts must be independently audited under the Listing Rules 9.8.2.(2).

The obligation of the auditors to report on the system of internal control is, however, not new for building societies in the UK.<sup>1</sup> The origin of the regulation dates back to the establishment of the Building Societies Act 1960 (BSA60). This Act was one of the few instances of planned change for the building societies; until then, most important regulatory innovations (including those dealing with financial disclosure) had been introduced following the demise of a building society (Drake, 1989:90). Indeed, the 1894 Act followed the collapse of the Liberator Building Society in 1892.<sup>2</sup> Changes associated with the 1960 Act were introduced earlier than expected after the State Building Society failed in 1959.<sup>3</sup> There was thus a long held view that the building society 'industry' was largely managed reactively rather than pro-actively.

Innovations introduced in BSA60 included new disclosure requirements, namely:

(a) the directors of a building society are liable to penalties, if they do not take all reasonable steps to ensure compliance with the requirements relating to:

- (i) the keeping of proper books of account, the maintenance of a system of control of the books and transactions and the safe custody of deeds and documents of title (Section 38);
- (ii) the keeping of records of the valuation of the security on which advances are made (Section 14 (4)); and
- (iii) the accounts to be laid before the society at the annual general meeting; the revenue and appropriation account must give a true and fair view of the income and expenditure of the society for the financial year and the balance sheet must give a true and fair view of the state of the affairs of the society as at the end of the financial year (Sections 39 and 40)...

(b) the auditors of the building society have a statutory duty to carry out such investigations as will enable them to form an opinion as to whether there has been compliance with the requirements referred to in (i) and (ii) above and, if not, to report accordingly; and they must report whether in their opinion the annual accounts referred to in (iii) above give the true and fair view required by the Act (Section 45).<sup>4</sup>

Research in this article examines how the auditors' reporting duty of internal control was originally introduced into BSA60. Describing L. R. Dicksee's experience gained through the audit of the Cardiff Building Society, Chandler *et al.* (1993: 446), with Kitchen and Parker (1980: 55), suggest that the building society fraud perpetrated in the late nineteenth century was an important cause for the primary audit objective to shift from 'statement verification' to 'fraud detection'. On the other hand, under the heading 'Statement Verification Re-emphasised', Chandler *et al.* (1993: 452) indicates that 'in the late 1920s and especially the 1930s, 'the change in audit objectives...gained wide acceptance'. However, regulatory innovations enacted in the BSA60 resulted in yet another reversion of the audit objective. This time from 'fraud detection' to 'statement verification'.

The change in the audit objective introduced in the Act of 1960 was later on expanded to all bodies corporate through the Companies Act 1967. In this sense, the BSA60 constituted a key success in lengthy representations made by the Institute of Chartered Accountants of England and Wales (ICAEW) on behalf of its members. Many of which were increasingly dissatisfied with the Eight and Nine Schedules of the Companies Act 1948.

In documenting the reversal of audit objectives enacted in BSA60, of special interest is a detailed examination of the dynamics between the Treasury, Chief Registrar of Friendly Societies (CRFS) and the ICAEW concerning the revision of the form of the auditors' report. Archival evidence documented in this article tells how chartered accountants were, through the extended negotiations, finally relieved through the BSA60 from 'the shackles imposed by nineteenth century legislation' (*Accountancy*, December 1960: 693). But in doing so, required them to take an alternative duty to report on internal control.

The remainder of this article proceeds in the following manner. The importance of audit of building societies, and the background of the establishment of BSA60, are reviewed in section 2, whereas the ICAEW's request for reform of the Ninth Schedule of the Companies Act 1948 (CA48) is examined in section 3. The following three sections present details of the negotiations between the ICAEW and the Treasury

(including Chief Registrar of Friendly Societies) concerning the reform of the form of the auditors' report. The final section offers summary and tentative conclusion.

### **Audit of Building Societies**

Building societies registered under the Industrial and Provident Societies Act 1893 and the Building Societies Act 1894 were required to employ 'Public Auditors' appointed by the Treasury. This was a front-runner to the introduction of the system of professional auditors in CA48 and its importance did not go unnoticed, as was recognised in paragraph 110 of the Cohen Committee Report (1945). Later on, the system of professional auditors was extended to all UK companies through Section 161 of CA48. (although CA48 introduced some exceptions which included the clearing banks - see further Billings and Capie, 2008). Section 161 also restricted eligible auditors to the members of associations of accountants recognised by the Board of Trade (BoT). Prior to being part of the register eligible auditors had to be members of either the Society of Incorporated Accountants and Auditors; the Association of Certified and Corporate Accountants; or members of any of the three bodies of chartered accountants (namely the ICAEW, the Institute of Chartered Accountants of Scotland and the Institute of Chartered Accountants in Ireland).<sup>5</sup>

Building societies became the main providers of finance for private occupancy as clearing banks and insurance companies left the market for residential mortgage loans during the inter-war period. The competitive advantage of building societies over any potential entrant became bigger during the late 1940s as an 'interest rate cartel' operated around the Building Society Association and in the mid-1950s, following regulatory changes that promoted occupancy of private dwellings (policies introduced by Conservative governments). The decades that followed the end of the war in Europe were thus a time of substantial expansion building societies' assets (see further Bátiz-Lazo, 2006).

In 1959, the State Building Society collapsed as a result of its directors making mortgage advances, without proper security, for bridging finance in take-over bids to a company in which the directors of the State were directors. This was called the 'Jasper affair' in the popular press and it led to the *accelerated* introduction of detailed disclosure requirements for the accounts prescribed in BSA60 (Sections 38 to 49 *Accounts and Audits*). *Accountancy* (December 1960: 693) reported that:

Members of Parliament and other interested in the management of building societies were aware that there was public concern as to the way in which certain societies were being conducted. Before legislation was promised, however, the worst happened in respect of one building society, and it was not until November 26, 1959, that the President of the Board of Trade stated in the House of Commons that the Chancellor of the Exchequer intended to introduce legislation.

As a direct result of the scandal, advances 'to any body corporate (or any advances to a person other than a body corporate in excess of ? 5,000) shall not in total exceed 10 per cent of the total loans made during the year' (*Accountancy*, April 1960: 215). The directors of a building society also had to 'disclose their interest in contracts with the society, and advances to directors or officers or to companies in which they are interested be shown in the annual return' (*Accountancy*, April 1960: 215-6).

Following the Eighth Schedule of CA48, disclosure requirements under BSA60 made specific requests as to the items to be disclosed in the accounts of building societies.<sup>6</sup> In addition, directors of a building society were explicitly required to maintain the systems of internal control.<sup>7,8</sup> 'To carry on the business of the society in an orderly manner, safeguard its assets and ensure the accuracy and reliability of its records.' (ICAEW, 1960: 7). Furthermore, as the highest standard for the information to be disclosed, the need to present a true and fair view was emphasised, again following the general guideline of CA48. The auditors had a statutory duty to carry out such investigations as to enable them to form an opinion as to whether there had been compliance with these requirements.

In the case of limited liability companies, the form of the auditors' report was prescribed in the Ninth Schedule of CA48. A possible inconsistency in the requirements of paragraphs 3 and 4 of the Ninth Schedule was, however, blamed as the source of confusion of auditors' comments (i.e., amplifications) from their qualifications (Kettle, 1954a: 250; 1954b: 277). The apparent inconsistency was the requirement that auditors were to state in their report whether the accounts of a company, excepted from disclosing certain specific particulars under Part III of the Eighth Schedule, gave a true and fair view subject to the non-disclosure. This apparent inconsistency resulted in the ICAEW informally approaching the Board of Trade, the authority responsible for the administration of CA48.

### **Reform of the Ninth Schedule**

In April 1951, the ICAEW submitted a memorandum proposing to revise the Ninth Schedule of CA48 to the Board of Trade. The Ninth Schedule stipulated the following duties for auditors:

1. whether they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit.
2. whether, in their opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them.
3. (1) whether the company's balance sheet and (unless it is framed as a consolidated profit and loss account) profit and loss account dealt with by the report are in agreement with the books of account and returns.  
  
(2) whether, in their opinion and to the best of their information and according to the explanations given to them, the said accounts give the information required by this Act in the manner so required and give a true and fair view—
  - (a) in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and
  - (b) in the case of the profit and loss account, of the profit or loss for its financial year;or, as the case may be, give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which by virtue of Part III of the Eighth Schedule to this Act are not required to be disclosed...

As mentioned, members of the ICAEW were dissatisfied with the wording of the last paragraph above. Kettle (1954a: 248), President of the ICAEW in 1950-51, for example, insisted that 'the auditors' report, based on the Ninth Schedule, has few

admirers. Its phraseology is verbose and condescends to matters of auditing and accounting detail of no interest to shareholders.’ The disaffection of ICAEW’s members stemmed the specificity with which they were required to word their report. In making representations of their membership the ICAEW suggested that the form be revised ‘by requiring reference to certain matters only in the event of the auditors finding it necessary to report on’ (Kettle, 1954a: 248). In its communication, the ICAEW suggested that:

The auditors’ report shall contain statements which in their opinion are necessary in any of the following circumstances if:

- (a) they have not obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit.
- (b) so far as appears from their examination, proper books of account have not been kept by the company.
- (c) proper returns adequate for the purposes of their audit have not been received from branches not visited by them.
- (d) the company’s balance sheet and profit and loss account are not in agreement with the books of account and returns from branches. (BT58/483: 18)

A related point of contention arose from Section 3 (2) (b) in the Ninth Schedule for companies exceptionally exempted from disclosing certain material information by the benefit of Part III of the Eighth Schedule. Clearing banks, for one, were allowed to hide the full extent of their reserves until 1970 (see further Billings and Capie, 2008). But that was not the case of building societies, whose disclosure requirements were regulated by the Treasury through the Chief Registrar of Friendly Societies. In tune with the sentiment of the time, Kettle (1954b: 284) publicly expressed his concerns:

The statement in Part III of the Eighth Schedule that the accounts of companies in the exempted categories which may be manifestly untrue and unfair in the accepted sense shall nevertheless be deemed to be true and fair (or as the schedule obliquely says, ‘shall not be deemed ...not to give the true and fair view...’) is a contradiction in terms. No auditor can report with any feeling of satisfaction that such accounts are true and fair when non-disclosure of material information is indicated either in the report itself or by reference to the wording of the Ninth Schedule.

Fuelling this concern was fear by ICAEW membership of possible legal action against individual auditors in the event that the truth and fairness of the accounts so exempted were disputed (Kettle, 1954a: 254). In its representations to the Board of Trade, the ICAEW suggested to modernise form of the report referring to:

- (b) whether in their opinion the balance sheet and profit and loss account of the company...the said accounts of the company and the group accounts, are properly drawn up so as to disclose the state of the company’s affairs at the date of its balance sheet and of its profit or loss for its financial year ended on that date, so far as is required by the provisions of this Act applicable to the class of company concerned.

As discernible from Kettle’s concern, the ICAEW proposal to revise the Ninth Schedule was motivated by its need to fully adapt to the new audit environment that emerged from the innovative accounting and auditing regulation introduced into CA48 in general and the ‘true and fair requirement’ in particular. CA48 significantly expanded statutory disclosure requirements by introducing provisions for filing with the Registrar of Companies and presenting to shareholders an audited balance sheet and profit and loss account containing the detailed accounting requirements set out in the Eighth



Schedule. The reforms envisaged in CA48 were interpreted as a significant event in achieving disclosure of relevant and effective information for investor decision-making (Board of Trade, 1945: 7-8; Edey, 1950: 308; Ryan, 1967: 95-7; Baxt, 1968: 301-6).

The Board of Trade gave its consideration to the ICAEW proposal to the extent that a member of staff even prepared a draft note to amend CA48 in relation to accounts and audit (BT58/483:12). But no further action was taken by the Board of Trade and so was noted to the ICAEW, informing that the issues raised the institute would be taken for consideration on occasion of a future revision. But at the same time and suggested by internal documents, within the Board of Trade there were doubts as to the merit of the issues raised. In an internal communication, J. Cowen opined about the ICAEW's memoranda that:

the Institute has produced very little...Most of the suggestions are neither urgent nor important, some are arguable, and one or two misconceived. (BT58/438: 3)

### **ICAEW and CRFS**

In spite of the Board of Trade's snub in 1951, discontent amongst members of the ICAEW's continued and was even voices publicly as the quotes from Kettle above suggest. The ICAEW's manoeuvring then re-started when the Parliamentary and Law (P&L) Committee of the ICAEW's Council examined, at its meeting held on 26 November 1956, a letter from a members firm, Jeffreys, Alfred Henry & Marks, requesting an inquiry on the 'statutory wording of the certificate required to be given on the accounts of a friendly society.'<sup>9</sup>

In response to the inquiry, the P&L Committee requested the ICAEW's technical machinery, the Taxation and Research (T&R) Committee, 'to make recommendations with a view to bringing these forms of [the auditors'] report into line in principle with the form recommended by the Council in its...memorandum to the Board of Trade'<sup>10</sup> made in April 1951. The purpose was to enable the P&L Committee to consider making representation to the appropriate government department, that is, the Chief Registrar of Friendly Societies (CRFS).<sup>11</sup> Moreover, the form of the auditors' report on the accounts of building societies was requested to be dealt with as 'a matter of urgency.'<sup>12</sup>

At the time, financial disclosure of building societies remained under the influence of nineteenth-century legislation. Specifically, auditors had been requested to certify in their report that the accounts of the building society were 'correct, duly vouched and in accordance with law', which was regarded as 'antiquated and insufficient words' (*Accountancy*, April 1960: 216). Financial reporting of building societies placed greater emphasis on 'fraud detection'. For instance, auditors had also been requested to certify that they 'actually inspected the mortgage deeds and other securities belonging to the society...and state the number of properties with respect to which deeds have been produced to and actually inspected'.

The ICAEW then took on steps to reform the form of the report of financial statements of building societies as an alternative to the failed attempt to reform the Ninth Schedule. Throughout this process, the ICAEW attempted to introduce what they regarded as a modern and ideal form into the report on the accounts of building societies, perhaps as a showcase of what could be (and needed to be) done elsewhere.

The T&R Committee on 21 February 1957 delegated the task to one of its sub-committees, the General Advisory Sub-Committee, within which another drafting sub-committee was formed to make recommendations as requested.<sup>13</sup> A memorandum was submitted to a meeting of joint representatives of the P&L and T&R Committees held on 3 October 1957.<sup>14</sup> As a result of the meeting it was recommended that ‘the accounts [of building societies] should be required to show a “true and fair view” with consequent change in the form of the auditors’ report’.<sup>15</sup> It was thought that ‘such a requirement would place upon the directors of a building society an obligation to present annual accounts...to disclose all important information’<sup>16</sup> and, through the introduction of the requirement:

It would be possible for the auditors to report in a manner which would be a greater protection to shareholders,<sup>17</sup> depositors and others interested in a building society. In their report, the auditors could be requested to state whether in their opinion the balance sheet and revenue account of the building society had been properly drawn up so as to give a true and fair view... (T233/1652)

The joint meeting also suggested that the Council should be recommended ‘to make a suitable statement drawing attention to the inadequacy of the auditors’ report on the accounts of building societies or to publish the statement as submitted.’<sup>18</sup> Shortly after, it was agreed at a meeting of the P&L Committee on November 25<sup>th</sup> 1957 that, based on the memorandum already prepared, ‘an informal approach be made to the Chief Registrar of Friendly Societies.’<sup>19</sup> For this purpose, S. J. Pears (Vice-Chairman of the P&L Committee) and J. H. Mann with three members from the T&R Committee were appointed as the representatives.<sup>20</sup>

A meeting with the Chief Registrar, Sir Cecil Crabbe, and his officials was held on 13 December 1957. As a result of the meeting, the Chief Registrar offered ‘to cooperate with representatives of the Institute in improving the form of annual accounts of building societies (Form A. R. 11)<sup>21</sup> and the Notes for the Guidance of Auditors’<sup>22</sup>, for which CRFS had power to prescribe. Rather than going along ICAEW’s original plan to reform solely the wording of the auditor’s report, the CRFS counter-proposed taking a broader look and amending Form A. R. 11. At its meeting of December 30<sup>th</sup> 1957, the P&L Committee decided to accept the Chief Registrar’s offer<sup>23</sup> and so instructed the ICAEW representatives.<sup>24</sup>

A second meeting with CRFS was held on January 3<sup>rd</sup> 1958.<sup>25</sup> Discussing included the possibility of introducing changes to Form A. R. 11 by enacting them through a new regulation. As a result of the meeting, the question of investments was discussed by the P&L Committee on February 24<sup>th</sup> 1958. During the latter, it was agreed that ‘as a minimum necessity the accounts should refer to the amount of the depreciation in value and that in advertisements issued by building societies the depreciation should not be obscured by the use of small type for the reference to market value.’<sup>26</sup>

Examining the ICAEW submissions made in March 1958, CRFS staff prepared a draft to amend the ‘Notes for Guidance of Auditors’<sup>27</sup> and submitted it ‘with a request for the views of the Institute representatives.’<sup>28</sup> Following the exchange with the ICAEW representatives, CRFS revised the draft and re-submitted it. During its meeting of October 27<sup>th</sup> 1958, the P&L Committee considered that the revised version was ‘in some respect weaker’<sup>29</sup> than the original. This view was then noted in the response to the Chief Registrar. In that letter, the Institute was very clear that it considered that

changes made between the original and revised drafts had weakened the guidance given by the notes and even commented that ‘their inclusion was very much regretted’.<sup>30</sup>

Not long after that, in December 1958 the CFRS invited the ICAEW to reconsider and comment on a revised Form A. R. 11.<sup>31</sup> These new set of changes, however, had been motivated by a statement made by Sir David Eccles, President of the Board of Trade, in the House of Commons on November 26<sup>th</sup> 1958. The purpose of Eccle’s address was to inform the House that: ‘the Chancellor of the Exchequer intends to introduce legislation concerning building societies during this session.’<sup>32</sup> This legislation was enacted in June 1959 as the House Purchase and Housing Act 1959. This Act included provisions giving building societies their much sought after goal of granting trustee status to their deposits as well as, for the first time in the history of British financial intermediation, specified statutory requirements for reserves and liquidity (see further Bátiz-Lazo, 2006). But in preparation for the new Act and perhaps in the expectation that trustee status would fuel further growth of mortgage advances by building societies, the Chief Registrar decided to revise their financial disclosure and ‘lay [statutory Form A. R. 11] before Parliament’ and for the purpose ‘sought the views of the Institute on the proposed new form.’<sup>33</sup>

During the meeting of December 29<sup>th</sup> 1958, the P&L Committee arranged to forward its draft of changes to the T&R Committee for comment. At the same time, the P&L Committee also formed a sub-committee, which would scrutinize and report on the response from the T&R Committee.<sup>34</sup> This exchange then became the basis for ICAEW’s communication to CRFS in May 1959.<sup>35</sup> The Chief Registrar, in turn, ‘expressed gratitude for the attention which has been given..by the representatives of the Institute and has promised to bear their comments in mind.’<sup>36</sup> The report of the P&L Committee dated May 25<sup>th</sup> 1959 recorded that:

a new form of A. R. 11...for building societies will shortly be introduced. This will embody some of the suggestions which have been made to the Registrar on behalf of the Institute...The new form A. R. 11 will not meet all the suggestions made on behalf of the Institute but it will represent a substantial improvement. (P&L Committee Minutes Book H: 178; T&R Committee Minutes Book C: 48).<sup>37</sup>

Staff at the CRFS then prepared a draft of the new ‘Notes for guidance in completing From A. R. 11’ and forwarded it to the ICAEW, which returned their comment as requested. As a reply, the CRFS staff expressed their view that ‘these comments were substantially acceptable to the Registrar.’<sup>38</sup>

## **ICAEW and the Treasury**

On September 28<sup>th</sup> 1959, the Times reported that:

The Prime Minister has confirmed the appointment of a committee to review the Companies Act and the Chancellor of the Exchequer has said that good progress has been made in preparing new building society legislation. The Jasper affair has certainly underlined the importance of both moves. (‘Raising Deposits from the General Public’, *The Times*, p. 14, col. A, 28-Sep-1959).

As the quote above suggest, the response to public outcry following the demise of the State Building Society had reached the top echelons of British government. Given their exchanges during the previous 21 months, the Treasury, Chief Registrar and ICAEW

were already looking at the case of reforming disclosure requirements of building societies. To little surprise, then, also on September 26<sup>th</sup> 1959 and ‘in view of a recent public indication that amendment of the legislation affecting building societies was under active consideration by the government’<sup>39</sup>, the P&L Committee requested the T&R Committee to prepare a memorandum ‘as a basis for the making of representations in regard to the legislation governing the accounts and audit of building societies.’<sup>40</sup> The P&L Committee also resolved that ‘a letter be sent forthwith to the Treasury (with copy to the Registrar) placing on record the Institute’s desire to be consulted.’<sup>41</sup> By October 26<sup>th</sup> 1959, the Treasury had acknowledged receiving the communication and said to be ‘considering the [Institute’s] request.’<sup>42</sup>

Without delay in October 22<sup>th</sup> 1959, the T&R Committee formed an ad-hoc sub-committee<sup>43</sup> to prepare and forward a memorandum to the P&L Committee.<sup>44</sup> The memorandum was considered and, as amended in minor points, submitted to the Council ‘with the recommendation that it be approved for submission to the Treasury with a copy to the Chief Registrar of Friendly Societies.’<sup>45</sup> The Council approved the document on December 2<sup>nd</sup> 1959.<sup>46</sup>

Explaining the background of the extended contact between the ICAEW and CRFS since December 1957, the memorandum stressed that ‘there has been a marked improvement in the form of A. R. 11.’<sup>47</sup> The memorandum then explained the fundamental reason for the need to reform the Building Societies Act 1894 as follows:

there is at present public concern as to the use that certain building societies make of the funds entrusted to them; whether the activities of organisations registered under the legislation relating to building societies should be restricted will no doubt be considered by those responsible for preparing new legislation. (P&L Committee Minutes Book I: 25)

The memorandum then explained the need to reform the regulation of the accounts and audit as follows:

the Council considers that all necessary steps should be taken to ensure that in the published accounts of a building society there is adequate disclosure of the use made of its funds and the state of its affairs and that this information is available to those who are attracted by its other literature and advertisements. (P&L Committee Minutes Book I: 25)

As a recommendation, the memorandum emphasised the need to introduce the ‘true and fair requirement’:

Accounts could be correct but might nevertheless omit information of importance. The directors of a building society should therefore be required to ensure that every balance sheet of the building society gives a true and fair view of its state of affairs as at the end of its financial year and that every income and expenditure account gives a true and fair view of its income and of its expenditure for the financial year. (P&L Committee Minutes Book I: 26)

For the auditors’ report, the memorandum suggested that the auditors should be required to report whether the balance sheet and income and expenditure account were drawn up so as to show a true and fair view, and that:

The auditors’ report should also contain statements which in the auditors’ opinion would be necessary in any of the following circumstances if:

- (a) they had not obtain all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit
- (b) so far as appears from their examination proper books of account had not been kept by the society

(c) proper returns adequate for the purpose of their audit had not been received from branches not visited by them

(d) the society's balance sheet and income and expenditure account were not in agreement with the books of account and returns from branches. (P&L Committee Minutes Book I: 27)

The memorandum specifically added that:

Assuming that properly qualified professional auditors are appointed it would be inappropriate to lay down detailed instructions regarding the manner in which the audit is carried out, including the present requirement that the auditors should certify that they have at each audit actually inspected the mortgage deeds in respect of each of the properties in mortgage to the society and the other securities belonging to the society. (P&L Committee Minutes Book I: 28)

These proposals to reform the form of the auditor's report were almost the same to those put forward to the consideration of the Board of Trade in April 1951.<sup>48</sup> In this submission to the Chancellor of the Exchequer, the ICAEW once again attempted to have auditors' report shaped to the Institute's ideal wording.

The Treasury accepted the ICAEW's request for consultation in drafting new legislation for building societies. This acceptance was undoubtedly influenced by the ICAEW's representations before the CRFS since 1957 in helping to improve Form A. R. 11. A letter dated October 14<sup>th</sup> 1959 from A. Vollmar at the Registrar of Friendly Societies to E. W. Maude, at the Treasury stated that:

The Institute of Chartered Accountants submitted [the memorandum] to us in March, 1958 and it formed the subject of discussion between ourselves and the Institute when the alteration of form A. R. 11 was under consideration. Some of the suggestions made in the memorandum were incorporated in form A. R. 11 which the Treasury approved on 12th June, 1959...In due course the Institute should as you say be invited for a talk and no doubt you will let us know when that is. (T233/1652)

Shortly after date was set for January 5<sup>th</sup> 1960 for a meeting between representatives of the ICAEW, Treasury, the Chief Registrar and CRFS staff to discuss the ICAEW memorandum.<sup>49</sup> A second meeting followed in February 22<sup>nd</sup> 1960 and, for the first time, included representatives of the Building Societies Association.<sup>50</sup> To this meeting 'two practicing auditors with long experience in dealing with building societies' were also invited to help put forward the view over proposed changes of building societies.

In a supplementary memorandum amplifying that prepared for the second meeting, the ICAEW re-emphasised the need to reform the form of the auditors' report as follows:

The existing statutory form of report is unrealistic and entirely out of tune with responsible auditing practice. It is in fact dangerous, in that it may convey a wrong impression of security. No auditor can do more than exercise reasonable care, caution and skill in carrying out his duties and then express his professional opinion on the accounts he has audited. A statutory obligation to 'certify that it is correct, duly vouched and in accordance with law' is likely to give an entirely false impression that the auditor is guaranteeing that everything is in order, whereas in fact it cannot enhance one title the responsibility that the auditor is capable of accepting. (T233/1652)

The ICAEW further summarised the essentials of what it considered to be the standards of auditing at the time in the following terms:

- (a) ascertainment of the system of bookkeeping and accounting
- (b) critical review of the system of internal control

(c) such tests and enquiries as the auditor consider necessary in the light of (a) and (b) and of what he finds in the course of those tests and inquiries

(d) examination of the income and expenditure account and the balance sheet in conjunction with the underlying records to ascertain whether they are substantiated thereby

(e) critical review of the income and expenditure account and the balance sheet in order to form an opinion on whether they are presented, and the items are described, in such a way that the accounts show not only a true but also a fair view (T233/1652)

These standards were ultimately adopted as form for building societies following repeated appeals of the ICAEW on behalf of its members. Success was in its grasp as made evident in an internal report of the P&L Committee on the meetings with the Treasury and CRFS:

As a result of the discussion there seemed to be general acceptance of the proposals regarding audit as set out in the Council's memorandum of 2<sup>nd</sup> December 1959 and amplified in the supplementary memorandum dated 7<sup>th</sup> January 1960 and it was therefore hoped that these proposals would be incorporated in the draft legislation. (P&L Committee Minutes Book I: 89)

'[T]he Building Societies Bill introduced in the House of Lords...incorporated in principle many of the proposals made by the Council in its memoranda to the Treasury', reported to the P&L Committee on 28 March 1960.<sup>51</sup> The P&L Committee also resolved to appoint a sub-committee 'to consider the Bill in detail and to make such representations on behalf of the Council as it might think fit within the framework of the Council's memoranda.'<sup>52</sup> The report of the sub-committee was submitted to the P&L Committee on 25 April 1960, which stated that:

although the submissions made by the Council [in its memoranda dated 2nd December 1959 and 7th January 1960] prior to the introduction of the Bill have in principle been substantially adopted, the Bill is nevertheless regarded as being in need of improvement in detail. (P&L Committee Minutes Book I: 120)<sup>53</sup>

The ICAEW made further representation to the Treasury. A meeting took place at the Treasury on May 3<sup>rd</sup> 1960 and additional material was submitted after that to substantiate ICAEW's case. A recollection of this meeting, nature of the additional submission as well as and the subsequent amendments made to the Bill during the Committee Stage in the House of Lords, was the content of a report prepared by the Deputy Secretary of the ICAEW, F. M. Wilkinson.<sup>54</sup> This report was presented at a meeting of the P&L Committee held on May 23<sup>rd</sup> 1960<sup>55</sup>, which recorded that:

during the Committee Stage in the House of Lords the Building Societies Bill was amended to give effect to some of the submissions made in the memorandum submitted on behalf of the Council to the Lord Privy Seal; the more important of the submissions have been covered by the amendments and in particular the clauses dealing with the audit report is in substance now in the form requested by the Council. (P&L Committee Minutes Book I: 135)

On the establishment of BSA60, *Accountancy* (December 1960: 693) commented:

The directors [of a building society]...are required to lay before their society at its annual general meeting a balance sheet which gives a true and fair view of the state of affairs of the society as at the end of its financial year and a revenue and appropriation account which gives a true and fair view of the income and expenditure of the society for the financial year.

For the auditors' duty, the same issue added that 'the auditors [of a building society] are now required to report whether in their opinion the accounts give the true and fair view required by the new Act' (*Accountancy*, December 1960: 693) and that

Chartered accountants who audit the accounts of a building society will welcome their release from the shackles imposed by nineteenth century legislation. Their new powers and responsibilities are similar to – and in some respect more onerous than – those of auditors of companies’ (*Accountancy*, December 1960: 693).<sup>56</sup>

### **Audit of Internal Control**

In spite of the apparent success as claimed in *Accountancy*, chartered accountants were, however, unable to completely break from their ‘nineteenth century shackles’. In the first memorandum submitted to the Treasury, the ICAEW, in relation to the form and content of the accounts of building societies, stated that:

Building societies should be required by statute to keep proper books of account. Suitable provisions for this purpose could be drawn up on the basis of the requirements of Section 147, 331 and 436 of the Companies Act 1948 with such adaptation and extension as may be necessary, including the need to maintain proper records of and control over the mortgage deeds and other assets. (P&L Committee Minutes Book I: 26)

On this proposal, a note dated January 8<sup>th</sup> and prepared by J. M. Bridgeman at the Treasury of the meeting held on January 5<sup>th</sup> 1960 with the representatives of the ICAEW recorded the following:

The Treasury and the Registrar questioned whether it was necessary to make specific provision for this in the Act, since there was a requirement on the auditors to inspect all mortgage deeds annually. The Institute said that the present requirement of such inspection was totally out of accord with modern methods of auditing, and that it was not in fact properly carried out at present. They felt that the correct method was for the Directors to be required to establish a proper system of control over the mortgage deeds, and for the auditors to have to examine that control to see that it was effective and to carry out sample checks. (T233/1652).

The meeting ended with disagreement over the issue of inspection of mortgage deeds. It was then agreed that the ICAEW would submit a further memorandum amplifying its original proposal. But Bridgeman’s note in fact added that:

The Treasury indicated that it would be difficult to include in the Bill anything which seemed to reduce the responsibility of auditors, and in particular they felt that the auditors should have to continue to certify that they had inspected all mortgage documents. (T233/1652).<sup>57</sup>

In the supplemental memorandum dated January 7<sup>th</sup> 1960, the ICAEW, under the heading of ‘Records and control’, stated that:

It is ...vital to the directors (who are responsible for the conduct of the society’s affairs, the safeguarding of its assets and the preparation of its annual accounts) and to the auditors (who are required to report on the accounts) that the society should maintain proper records of and control over the mortgage deeds and other assets...To the knowledge of members of the Institute who have experience of building societies it cannot be said at present that all societies maintain proper records of and control over the mortgage deeds. The Council therefore considers that a statutory obligation to do so would have a salutary effect in addition to strengthening the position of the auditor, or the Registrar, or a prosecuting authority, in the event of difficulties being experienced. (T233/1652).

As to the inspection of mortgage deeds, the memorandum specifically stated:

The present requirement that the auditor shall certify that he has ‘at this audit actually inspected the mortgage deeds in respect of each of the properties in mortgage to the society’ is neither practicable nor necessary in the case of a society of any size. It is important that the auditor should make a critical examination of the system of control over the handling and custody of

deeds...and make a thorough scrutiny of a selected number of mortgage deeds and of the supporting documents; this is in line with modern audit practice and is of much greater value than the making of a cursory and superficial examination of all the mortgage deeds in the possession of the society. (T233/1652).<sup>58</sup>

The Treasury and CRFS were prepared to accept the ICAEW's proposal that the directors should be required to establish and maintain a proper system of internal control. In fact, instructions made to the office of the Parliamentary Counsel included the following provisions:

- (a) Every society shall keep proper books of accounts recording its transactions and such books shall not be deemed to be kept if there are not kept such books as are necessary to give a true and fair view of the state of the society's affairs and to explain its transactions.
- (b) Every society shall keep proper records of its assets, including all deeds relating to properties mortgaged to the society, and shall have in operation a proper system for the safe custody of such deeds. Proper records shall not be deemed to be kept unless they show particulars of the movements of deeds and where for the time being the deeds may be found. Such records shall be kept at the registered office of the society and, where necessary also at any branch office. (doc 22 in T 233/1652: Confidential communication from Treasury and Chief Registrar to Office of the Parliamentary Counsel - date 26-Jan-60).

However, regarding the auditors' duty to inspect mortgage deeds, they kept their original stance unchanged as illustrated by the following provision:

- (a) The auditor shall report...that the account and balance sheet...give a true and fair view of the society's affairs at the end of the financial year and its income and expenditure and of its appropriations for that year...and that he has at the audit inspected mortgage deeds and other securities belonging to the society stating the number of properties to which deeds have been produced to and actually inspected by him. (doc 22 in T 233/1652: Confidential communication from Treasury and Chief Registrar to Office of the Parliamentary Counsel - date 26-Jan-60).

On February 22<sup>th</sup> 1960, the second meeting took place between the Treasury (including CRFS) and the ICAEW. Through extended negotiations, the Treasury finally instructed the Parliamentary Counsel to change the auditors' reporting duty in the following terms:

- (a) The auditor shall make a report on the society's revenue and appropriation account and balance sheet...
- (b) The report shall contain a statement...whether in his opinion the accounts and balance sheet...give a true and fair view of the society's affairs at the end of its financial year and of its income, expenditure and appropriations for that year...
- (c) The report shall also contain a statement as to: -
  - (i) whether the auditor has had access at all times to the books, accounts, vouchers and deeds of the society;
  - (ii) whether, so far as appeared from the auditor's examinations thereof, proper books of account have been kept by the society;
  - (iii) whether in conducting his audit, the auditor has had regard to the system of internal checks and audit, if any, maintained by the society;
  - (iv) whether in the auditor's opinion, the society has maintained proper records of its assets, and has in operation a system which will ensure the safe custody of the deeds relating to property mortgaged to the society at all times and their control by the society. (T233/1652)

In essence, the Treasury and CRFS conceded to the stance of the ICAEW. The Chief Registrar, Sir Cecil Crabbe, privately deplored the loss of the auditors' duty to inspect



the mortgage deeds as evident in internal communication with the Treasury:

We have now, quite rightly I think, given way to the accountants on the question of inspection of mortgage deeds. I say quite rightly because it appears that the duty which the present Act places upon auditors to inspect all deeds is one which it appears they cannot reasonably and efficiently perform...I was not entirely happy about the result of giving way on the point. We have lost a singularly important safeguard constituted by the need for someone each year to see that all society's mortgage assets are covered by mortgage deeds. What is now going to take its place, namely, the inspection of system of control and selective check of mortgages, will undoubtedly satisfy any audit procedure...but will not in my view constitute as adequate a safeguard as is needed for the benefit of small investors. (doc 2 in T233/2095 - Memo from Chief Registrar [Sir Cecil Crabbe] to Treasury [Figgures]- dated 29 Feb 1960).

Sir Cecil Crabbe added that:

In the past the auditor has...to a great extent played the part of guardian in so far as he was required by statute to inspect the securities...Now that he is no longer such person (although he will undertake inspection of a kind)...(T233/1652)

Although the Treasury and CRFS made the substantial concessions to the ICAEW, they remained firm on the requirement of auditors' alternative duty to report on internal control. This was in turn reported to the P&L Committee of the ICAEW Council in the following terms:

It would be an essential part of the duty resting upon the auditor that where he is not satisfied with the building society's system of internal control, including the procedure for making loans and the custody of deeds, he should include appropriate comment in his report. (P&L Committee Minutes Book I: 89)

It was added that 'the Institute representatives had undertaken [to the Treasury] that the Council would issue to members an auditing statement for the guidance of auditors of building societies.'<sup>59</sup> As a response, the P&L Committee requested the T&R Committee 'to prepare...a draft auditing statement relating to building societies.'<sup>60</sup> The T&R Committee appointed an ad hoc sub-committee for this purpose.<sup>61</sup> At a meeting of joint representatives of T&R and P&L Committees held on April 8<sup>th</sup> 1960, matters to be dealt with in the proposed document were enumerated as follows:

- (1) System of internal control
- (2) Tests of the system of internal control to be carefully selected and to be in depth.
- (3) Books properly kept means that the books are up to date.
- (4) Window dressing.
- (5) Transactions involving directors to be scrutinised and to be reported on if they are not approved by an independent quorum of directors.
- (6) The proper control over deeds requires consideration of the period the deeds are out of the custody of the society. Also spot checks to be required.
- (7) Consideration of control exercised by the board over lending policy.
- (8) Provision for bad debts.
- (9) Form of audit report. (P&L Committee Minutes Book I: 144)

As shown in the quote above, the importance of addressing the issue of internal control was stressed by placing it first in the list. This was also noted in the media:

Much of the [Building Societies Act 1960] is devoted to assimilating building society law to company law in the matter of publicity and accounts ... However, the clause goes much further:

societies must also establish and maintain a system of control and inspection of their books and a system for supervising their cash, receipts and remittances. Each must also establish and maintain a system to ensure safe custody of mortgaged property ... Clause 40 requires the auditor's report on the accounts, the report to contain details to ensure the persons reading the report are in no doubt as to whether the new requirement of the law have been met (*Accountancy*, April 1960:395).

adding about the duty of auditors:

The directors [of a building society] now have a statutory duty to ensure that there is a proper system of accounting and control...the scope [of the auditor's duty] extending to...the keeping of the records of the valuations of the securities on which advances are made, the keeping of proper books of account, the maintenance of a system of control of the books and transactions and the safe custody of deeds and documents of title. (*Accountancy*, December 1960: 693)

Interestingly, some London societies (including the London & District Society) voiced their opposition to the issuance of the guidance for it being needlessly restrictive and patronizing. Against the opposition and to ensure the implementation of the audit of internal control, the P&L Committee re-stressed the fact that the ICAEW had undertaken to the Treasury to 'issue to members after the enactment of the Building Societies Act 1960 a statement for guidance of auditors of building societies.'<sup>62</sup>

The ad-hoc T&R sub-committee prepared and submitted a memorandum.<sup>63</sup> The draft was then amended in some points at a meeting of joint representatives of T&R and P&L Committees held on October 20<sup>th</sup> 1960. Changes were in accordance with the contents of the newly enacted Building Societies (Accounts) Regulations 1960 and the Building Societies (Annual Return and Auditor's Report) Regulations 1960.<sup>64</sup> The P&L Committee scrutinised the revised memorandum and the Council then finalized the document for publication 'as a statement for guidance on the audit of building societies accounts' on December 7<sup>th</sup> 1960.<sup>65</sup> In the document entitled *Audits of Building Societies* issued in 1960, it was stated that:

Emphasis is here placed on the vital need to ascertain and test the system of internal control, not merely because of the auditors' duty under Section 45 (4) [the auditors' reporting duty on internal control] but because this is fundamental to all responsible auditing...By 'internal control' is meant the whole system of controls, financial and otherwise, established by the management in the conduct of a business, including internal check, internal audit and other forms of control. It covers everything which the management of a building society should arrange, whether required by the Act or not, in order to carry on the business of the society in an orderly manner, safeguard its assets and ensure the accuracy and reliability of its records...The auditors should compile and maintain an up-to-date record of the system of internal control, obtaining copies of rules, standard forms, internal instructions and any publications showing terms of business. This record should cover each aspect of the society's activities (such as advances, shares, deposits, custody of assets, handling of cash). (ICAEW, 1960: 7)

*Accountant* (24 December 1960) reported the publication of the ICAEW's guidelines as follows:

The Council of the Institute of Chartered Accountants in England and Wales has published a statement ... setting out the provision of the new Act relating to the accounts and audit [of building societies]. The fundamental change in essence, is that the audit of a building society's accounts is no longer merely an identification parade of its transactions, so that the auditor can consciously say that the annual statement is 'correct, duly vouched and in accordance with law'. It devolves on the directors to produce intelligible accounts and on the auditor to report that they are 'true and fair' or otherwise and the Council's pellucidly clear statement should make his preparatory task of revising audit procedures and programmes very much easier.

In summary, The Treasury, by reforming the Building Societies Act and

incorporating in the substance the ICAEW's proposal, relieved them from 'the shackles imposed by nineteenth century legislation' (*Accountancy*, December 1960: 693), but this required the accountants to take an alternative duty to report on internal control.

## Summary and Conclusions

The objective of research in this article was to explore how the audit of building society changed in the reversion of the audit objectives re-emphasising 'statement verification' that occurred in the late 1950s. For the purpose, this article looked at a series of negotiations between the ICAEW and the Treasury (including CRFS) over the reform of the form of the auditors' report, which was realised through the establishment of BSA60. Interestingly, individual societies and their association were conspicuously absent from the negotiations. Failure to make effective representation of building society interests was surprising because the Building Societies Association has been very active in representing its members' interest during the drafting of the Building Societies Act 1939 as well as the body which managed the agreement that limited potential entrants into the residential mortgage market (i.e. 'the interest rate cartel').

Dissatisfied with the form prescribed and to be adaptive to the new audit environment brought about by the innovative requirement of the Companies Act 1948 (CA48), the ICAEW in April 1951 proposed to reform the Ninth Schedule of CA48, but at the time the Board of Trade was unsympathetic to the proposal on the grounds that it was 'neither urgent nor important' (BT58/438: 3). But dissatisfaction amongst the ICAEW membership remained. In 1956 the Institute once again made representations on behalf of its members when the P&L Committee decided to approach the Chief Registrar of Friendly Societies (CRFS). The intent was breaking with what was considered by the accountants an outdated practice and replace it with a more 'modern' form of the auditors' report in the accounts of building societies. The ICAEW then took advantage of the opportunity to co-operate with the CRFS in improving Form A. R. 11, as a way to legitimise its own view and in due course, overstep the CRFS 'to make proposals and to be consulted on the drafting of new legislation relating to the accounts and audit of building societies' directly to the Treasury.<sup>66</sup>

As evident in its two submissions, the ICAEW not only advocated that the auditors be required to report whether the accounts of building societies were drawn up so as to show a true and fair view, but also proposed to make a statutory provision requiring the directors to establish and maintain a proper system of internal control. These proposals were adopted by the Treasury, subject to the introduction of the auditors' reporting duty on internal control.

To ensure the implementation of the new audit procedures, the ICAEW undertook to 'issue to members a statement for the guidance of the auditors of building societies.'<sup>67</sup> In *Audits of Building Societies*, it was stated that 'Emphasis is here placed on the vital need to ascertain and test the system of internal control' (ICAEW, 1960: 7).

The Act of 1960 thus relieved chartered accountants from the 'out of tune' (T233/1652) practice established by nineteenth century legislation in which the primary audit objective was regarded to be 'fraud detection' (Chandler *et al.*, 1993:446; Kitchen

and Parker, 1980:55; and Lee, 1977: 98). The Act reintroduced ‘statement verification’ as the main audit objective. But to be able to do required auditors to take the alternative duty to report on the nature and quality of internal control.

More recently, Section 404 of the Sarbanes-Oxley Act in the USA required auditors to report on management’s internal control. This assessment was introduced in response to instances of fraudulent reporting or misstatements exposed in the cases of Enron and WorldCom. In other words, the audit objective becomes ‘statement verification’. But as illustrated by research in this article, the duty of auditors to report on the system of internal control introduced in Britain by the Building Societies Act 1960 was enacted as an additional duty of the auditor. Auditors rather than directors are then considered the ultimate guardian of the building society’s assets. Auditors had been originally required to inspect all the mortgage deeds in custody by the society as well as securities other than mortgage advances in which deposits had been invested. This reflected how nineteenth century legislation had emphasised ‘fraud detection’ as the audit objective. Over a quarter of a century after the passing of the 1960 Act, the tradition remains as reflected in current British regulation over the auditor’s report (as expressed in the review of the effectiveness of internal control). Indeed, Principle C.2 of the *Combined Code on Corporate Governance* revised in June 1006, maintained that ‘the Board should maintain a sound system of internal control to safeguard shareholders’ investments and company’s assets.’ (page??)

### **Postscript: Reform of the Ninth Schedule Revisited**

On December 10<sup>th</sup> 1959, Reginald Maudling, the then recently appointed President of the Board of Trade, asked the Jenkins Company Law Committee ‘to consider in the light of modern conditions and practices, including the practice of takeover bids, what should be the duties of directors and the right of shareholders; and generally to recommend what changes in [company] law are desirable’. Submissions were made by several accountancy bodies, including the ICAEW. As to the form of the auditors’ report, the ICAEW memorandum dated March 17<sup>th</sup> 1961 followed the same line of thought made earlier in April 1951. The March 1961 communication proposed revising the Ninth Schedule as follows:

- (1) In their report the auditors shall state:
  - (a) whether in their opinion the balance sheet and profit and loss account of the company or, in the case of a holding company submitting group accounts, the said accounts of the company and the group accounts, are properly drawn up in accordance with the provisions of this Act so as to give a true and fair view of the state of the company’s affairs at the date of its balance sheet and of its profit or loss for its financial year ended on that date; or
  - (b) in the case of a company entitled to the benefit of Part III of the Eighth Schedule to this Act, whether in their opinion the balance sheet and profit and loss account of the company or, in the case of a holding company submitting group accounts, the said accounts of the company and the group accounts, are drawn up in accordance with the provisions of this Act so as to disclose, to the extent required by the Act for the class of company concerned, the state of the company’s affairs at the date of its balance sheet and its profit or loss for its financial year ended on that date.
- (2) The auditors’ report shall contain statements which in their opinion are necessary if:

- (a) they have not obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit; or
- (b) so far as appears from their examination, books of account have not been properly kept by the company; or
- (c) proper returns adequate for the purposes of their audit have not been received from branches not visited by them; or
- (d) the company's balance sheet and profit and loss account are not in agreement with the books of account and returns from branches. (Board of Trade, 1962: 1428)

Accepting the ICAEW submission as it was, the Jenkins Committee, for the reform of the Ninth Schedule, recommended that:

the Ninth Schedule requires the auditors to state expressly their opinions on a number of other specific matters...It is suggested that these express statements are unnecessary and that it should be enough for auditors who are satisfied about these matters simply to state their opinion on whether the accounts present a true and fair view...

the auditors' report on the accounts of a company which has taken advantage of the exemptions at present conferred upon banking, discount and insurance companies and shipping companies...is required to state that the accounts present a true and fair view subject to the non-disclosure of matters which by virtue of Part III of the Eighth Schedule are not required to be disclosed...it is contended, accounts that do not disclose these matters may present a view that is neither true nor fair and it is wrong to require auditors to use words which could be misunderstood...

...at paragraphs 435 (h) and (i) below we recommend the substitution of a new form of auditors' report, which is largely based on the submission made to us on this subject by the Institute of Chartered Accountants in England and Wales. (Board of Trade, 1962: 167).<sup>68</sup>

The ICAEW's earnest wish to reform the Ninth Schedule found its final outlet in the Report of the Jenkins Committee issued in 1962. This report was accepted, without amendment, by the Board of Trade and enacted as the Companies Act 1967.

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## Notes

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<sup>1</sup> Building societies are mutual organizations, which for much of their history specialised in liquidity creation by turning retail deposits into mortgage loans.

<sup>2</sup> Disclosure requirements for building societies dated to the Building Society Act 1894, which gave the Chief Registrar of Friendly Societies power to intervene in the affairs of societies and required full accounting disclosure and professional audits (Phillips, 1983: 4).

<sup>3</sup> Regulation concerning building societies was subsequently re-grouped into the Building Societies Act 1962.

<sup>4</sup> The ICAEW commented on BSA60 as follows: 'Subsection (4) of Section 45 places a positive duty on the auditors to carry out such investigations as will enable them to form an opinion on certain matters which they are not required to refer to in their report unless they form an adverse opinion. The absence of any comment in their report is therefore equivalent to a positive statement by the auditors that they have investigated and satisfied themselves on all the...matters' (ICAEW, 1960: 5).

<sup>5</sup> Subsection (1) (b) of Section 161 also prescribed the following persons as eligible: 'those who were for the time being authorized by the Board of Trade to be so appointed by either having similar qualifications obtained outside the United Kingdom or as having obtained adequate knowledge and experience in the course of employment ... or as having ... practiced in the Great Britain as an accountant.'

<sup>6</sup> In reforming Building Societies Act, the Treasury and the Chief Registrar of Friendly Societies took views from some interested groups including the ICAEW and the Building Societies Association (Registry of Friendly Societies, 1961: 14).

<sup>7</sup> The importance of testing the effectiveness of internal control in conducting audit of accounts had been recognized in the early 20<sup>th</sup> century, as demonstrated in the Preface to the first edition of Spicer and Pegler's *Audit Programmes* (1908: 4). Concerning the widespread adoption after World War II of the systems-based approach in auditing, the ICAS (1954: 72) stated that 'There is little doubt that these demands [on manpower during World War II] resulted in some relaxation of standards of auditing work, but in so far as this merely eliminated repetitive checks and led to a greater reliance on proper sampling and to emphasis on the importance of adequate internal control, the changes may well have been beneficial'.

<sup>8</sup> The Building Societies Association circulated guidelines for internal control as early as 1947 (Bátiz-Lazo, 2006). However, evidence in Perks (1977) and Drury (1994) suggests the practice did not develop into management accounting until much later.

<sup>9</sup> P&L Committee Minutes Book G: 36.

<sup>10</sup> P&L Committee Minutes Book G: 39.

<sup>11</sup> P&L Committee Minutes Book G: 39.

<sup>12</sup> P&L Committee Minutes Book G: 103.

<sup>13</sup> Members of the drafting sub-committee were: R. D. R. Bateman, J. H. Mann (Chairman), G. H. Yarnell, G. G. G. Goult, A. Rayner, D. E. T. Tanfield, A. B. Show (co-opted) and F. C. A. Ledsam (co-opted) (T&R Committee Minutes Book B: 200).

<sup>14</sup> T&R Committee Minutes Book B: 216.

<sup>15</sup> P&L Committee Minutes Book G.: 125.

<sup>16</sup> T233/1652.

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- <sup>17</sup> As mutual organizations, building societies were owned by members and managed by directors appointed by members in the annual general meeting or AGM (this as opposed to trustee savings banks; other British mutual organization whose directors were appointed by the Treasury). Members were in effect long term depositors, who acquired 'a share', that is, they were paid a slightly higher rate of interest than depositors (in the 1950s, it was about 0.5 and 1.0 per cent). The latter received a lower interest rate to have their savings returned on demand. Regardless of the amount held in deposits or 'shares', each member had only one vote in the AGM whereas depositors had no right to vote.
- <sup>18</sup> P&L Committee Minutes Book B: 216.
- <sup>19</sup> P&L Committee Minutes Book G: 141.
- <sup>20</sup> They were: G. G. G. Goult, A. Rayner and F. C. A. Ledsam (P&L Committee Minutes Book G: 141).
- <sup>21</sup> The Building Societies Acts, 1874-1940 prescribed Form A.R. 11 which should summarise the annual accounts and statement for individual building societies. This would include general information (name of the society, registered office, date of incorporation total membership at year end, name and address of directors); a balance sheet (using as headings for capital and liabilities: shares, H.M. Government advances, other deposits and loans; and for assets: mortgages and investments); revenue and appropriation account; mortgage losses account; other provision account; general reserve account; special schedules (providing statistical information on mortgages, investments, special advances, etc.).
- <sup>22</sup> P&L Committee Minutes Book G: 148.
- <sup>23</sup> P&L Committee Minutes Book G: 148; T&R Committee Minutes Book B: 231.
- <sup>24</sup> P&L Committee Minutes Book G: 148.
- <sup>25</sup> P&L Committee Minutes Book G: 165; T&R Committee Minutes Book B: 237.
- <sup>26</sup> P&L Committee Minutes Book G: 176.
- <sup>27</sup> These were distributed each year to all societies by the office of the Chief Registrar together with a printout of Form A.R. 11.
- <sup>28</sup> P&L Committee Minutes Book G: 237; T&R Committee Minutes Book B: 249.
- <sup>29</sup> P&L Committee Minutes Book H: 49; T&R Committee Minutes Book B: 267.
- <sup>30</sup> P&L Committee Minutes Book H: 49; T&R Committee Minutes Book B: 267.
- <sup>31</sup> P&L Committee Minutes Book H: 164.
- <sup>32</sup> P&L Committee Minutes Book I: 43.
- <sup>33</sup> P&L Committee Minutes Book H: 165.
- <sup>34</sup> Members were: S. J. Pears (Chairman of the P&L Committee), J. Clayton (Vice-Chairman of the P&L Committee), J. H. Mann and G. G. G. Goult (P&L Committee Minutes Book H: 165).
- <sup>35</sup> P&L Committee Minutes Book H: 172; T&R Committee Minutes Book C: 37.
- <sup>36</sup> T&R Committee Minutes Book C: 37.
- <sup>37</sup> The amendments to the statutory Form A. R. 11 were introduced with the enactment of the Building Societies (Accounts) Regulations 1960 and the Building Societies (Annual Return and Auditor's Report) Regulations 1960.
- <sup>38</sup> P&L Committee Minutes Book H: 217.
- <sup>39</sup> P&L Committee Minutes Book H: 218.
- <sup>40</sup> P&L Committee Minutes Book H: 218.
- <sup>41</sup> P&L Committee Minutes Book H: 218.
- <sup>42</sup> P&L Committee Minutes Book H: 227.
- <sup>43</sup> Members were: C. V. Best, G. N. Hunter, C. R. P. Goodwin, F. C. A. Ledsam, G. R. Appleyard, J. W. Margetts, R. A. Palmer, B. Rose and R. T. Walters (T&R Committee Minutes Book C: 60).
- <sup>44</sup> P&L Committee Minutes Book I: 13; T&R Committee Minutes Book C: 76.
- <sup>45</sup> P&L Committee Minutes Book I: 13.
- <sup>46</sup> P&L Committee Minutes Book I: 49.
- <sup>47</sup> P&L Committee Minutes Book: I: 25.
- <sup>48</sup> P&L Committee Minutes Book I: 27.
- <sup>49</sup> For this purpose, the P&L Committee appointed H. A. Benson (Chairman of the P&L Committee), S. J. Pears (Vice-President), G. R. Appleyard, R. T. Walters and J. H. Mann as the representatives (P&L Committee Minutes Book I: 50). The Treasury representatives were Figures, Maude, Bridgeman and



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Parmella, the Chief Registrar (Sir Cecil Crabbe) and two assistants namely, Leigh and Vollmar (doc 18 in T 233/1652 - Minutes of the meeting between the Treasury and Chief Registrar – entitled “Proposals for Building Societies’ Legislation”).

<sup>50</sup> T&R Committee Minutes Book C: 83; P&L Committee Minutes Book I: 71; T233/1652 (doc 24).

<sup>51</sup> P&L Committee Minutes Book I: 104.

<sup>52</sup> Members were: the Chairman, H. A. Benson, J. H. Mann, E. R. Nicholson and R. T. Walters (P&L Committee Minutes Book I: 104).

<sup>53</sup> *Accountancy* (April 1960: 216) commented that the auditor ‘will have to certify that he is satisfied under seven stipulated heads, one of which is that the accounts give a true and fair view. The seven heads seem excessive and unnecessary: much less elaborate requirements are laid down in the Companies Act. It would have been more satisfying if, instead, specified matters had been laid down (but under fewer than seven heads!) to which the auditor should refer if he had not been able to make a complete or satisfactory audit’.

<sup>54</sup> As to the amendments made, *Accountancy* (June 1960: 317) reported that ‘A major change made by the House of Lords in the Building Societies Bill was the re-writing of the Clause on the auditor’s report (now Clause 44)...Then comes three heads, in place of the seven, giving the matters to which the report must refer if the auditors are not satisfied – they are (1) if the society has failed to keep proper books of account or proper records (as laid down); (2) if it has failed to maintain a satisfactory system of control over its transactions and records; and (3) if the balance sheet and revenue and appropriation account are not in agreement with the books of account and records’.

<sup>55</sup> P&L Committee Minutes Book I: 128-9.

<sup>56</sup> The substance of the ICAEW proposals regarding the accounts and audits of building societies were also reflected into the Building Societies (Accounts) Regulations 1960 and the Building Societies (Annual Return and Auditor’s Report) Regulations 1960.

<sup>57</sup> The other memorandum prepared by CRFS commenting on the ICAEW memorandum, in advance to the meeting with the ICAEW, also stated that: ‘These suggestions would relax auditors’ duties and are not recommended’ (T233/1652).

<sup>58</sup> Not only the ICAEW, but the largest society in terms of assets in the UK, the Halifax Building Society, wanted to avoid requiring the auditors to inspect all mortgages annually. They considered it enough that obligations similar to the Ninth Schedule of CA48 should be imposed on them (T233/1652- Anonymous. probably a communication between civil servants spearheading the Bill, namely from Vollmar at the Register of Friendly Societies to EW Maude at the Treasury. It could have well been prepared at the Treasury as part of the preparations for the meeting of 04-Jan-60. Among other things, the tabular form summarizes memoranda from the Building Society Association or BSA [8Dec-59] and from the Halifax Building Society [19Dec-59], which at the time was not part of the BSA. The document dates to circa 2/Jan/60).

<sup>59</sup> P&L Committee Minutes Book I: 89.

<sup>60</sup> P&L Committee Minutes Book I: 90; T&R Committee Minutes Book C: 89.

<sup>61</sup> Members were: S. M. Duncan, A. G. Thomas, J. Perfect, G. R. Appleyard, F. C. A. Ledsam, E. R. Nicholson and R. T. Walters (T&R Committee Minutes Book C: 89).

<sup>62</sup> P&L Committee Minutes Book I: 221; T&R Committee Minutes Book C: 108.

<sup>63</sup> T&R Committee Minutes Book C: 109.

<sup>64</sup> P&L Committee Minutes Book I: 209; 239.

<sup>65</sup> P&L Committee Minutes Book I: 238; P&L Committee Minutes Book J: 13; T&R Committee Minutes Book C: 129.

<sup>66</sup> P&L Committee Minutes Book H: 227.

<sup>67</sup> P&L Committee Minutes Book I: 89.

<sup>68</sup> The Jenkins Committee recommend that:

(h) the Ninth Schedule should be amended to require the auditors’ report to state: ...

(i) whether in their opinion the balance sheet and profit and loss account of the company (or, where group accounts are submitted, the said accounts of the holding company and the group accounts) are properly drawn up in accordance with the provisions of the Act so as to give a true and fair view of the state of the company’s affairs at the date of its balance sheet and of its profit or loss for its

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financial year ended on that date; or

(ii) (in the case of a company which has taken advantage of the exemptions conferred by Part III of the Eighth Schedule) whether in their opinion the balance sheet and profit and loss account (or those accounts and the group accounts as the case may be) are drawn up in accordance with the provisions of the Act;

(i) the auditors' report should be required to contain any qualification which they think necessary in relation to the matters now mentioned in paragraphs 1, 2 and 3 (1) of the Ninth Schedule. (Board of Trade, 1962: 168).