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The Auditors’ Reporting Duty on Internal Control: The Case of Building Societies, 1956-1960

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by

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Abstract
In this article, informed through application of the corporatist theory, we explore how the audit of building societies saw, in the late 1950s, a transition of audit objective from ‘fraud detection’ to ‘statement verification’ (Chandler et al., 1993: 452). The study proceeds through analysing negotiations between the Institute of Chartered Accountants in England and Wales (ICAEW) and the state authorities, such as the Treasury (including the Chief Registrar of Friendly Societies) and the Board of Trade, concerning the audit procedure applied to the accounts of building societies by the Building Societies Act 1960 (BSA60). We show how regulatory change relieved chartered accountants from ‘out of tune’ (T233/1652) practices established by nineteenth century legislation, under which the auditors rather than the directors had been expected to take responsibility for safeguarding the assets of building societies. To achieve such regulatory change, auditors were alternatively required to assume a new duty to report on the system of internal control.

Keywords: building societies; corporatism; the auditors’ reporting duty on internal control; the ICAEW; the Treasury; Building Societies Act 1960 (BSA60)

Introduction
Section 404 of the Sarbanes-Oxley Act, enacted on July 30th, 2002, required each corporation 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. 6R. (6), to state whether they had complied with all relevant provisions set out in Section 1 of the Combined Code on Corporate Governance (Financial Reporting Council, 2006) in the annual financial report. 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’. Finally but not least importantly, the director’s report on internal control must be independently reviewed by the auditors under the Listing Rules 9. 8. 10R. (2).

The duty of the auditors to report on the system of internal control is, however, not new for building societies in the UK. 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, 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, whereas the 1939 Act emerged from the publicity given to the ‘Borders case’. There was thus a long held view that the building society ‘industry’ was largely managed reactively rather than pro-actively. Changes associated with the 1960 Act were, however, introduced earlier than expected after the State Building Society failed in 1959. Innovations introduced in BSA60 also 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).

Research in this article examines how the auditors’ reporting duty of internal control was originally introduced into BSA60. By so doing, it aims to shed light on norms regulating financial disclosure peculiar to financial intermediaries that were different from other bodies corporate (particularly publicly listed companies). At the same time, we show continuity between building societies and listed companies in the process of reforming the form of the auditor’s report.

Describing L. R. Dicksee’s experience gained through the audit of the Cardiff Building Society, Chandler et al. (1993: 446; see also Lee, 1977: 98; 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 recognized in various accounting and auditing legislations to have shifted from ‘statement verification’ (detection of misstatements due to management manipulation) to ‘fraud detection’ (detection of fraud and the commission of errors). 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’. The regulatory innovations enacted in BSA60 reflected this reversion of the audit objective, though belated in the 1960s, in the field of building societies.

On the other hand, the reform of the form of the auditors’ report that resulted from the regulation introduced by BSA60 was later on expanded to all bodies corporate through the enactment of the Companies Act 1967. In this respect, BSA60 constituted a key success in lengthy representations made by the Institute of Chartered Accountants in England and Wales (ICAEW) on behalf of its members, many of which had been increasingly dissatisfied with the Ninth Schedule of the Companies Act 1948 (CA48). In documenting the introduction of the new regulatory innovations into BSA60, of special interest is a detailed examination of the extended informal negotiations between the Treasury, including its competent department, i.e. Chief Registrar of Friendly
Societies (CRFS), and the ICAEW over the audit procedure to be applied for the implementation of the new regulations of BSA60. Archival evidence to be presented in this article will show how chartered accountants were, through the extended negotiations, finally relieved, through BSA60, from ‘the shackles imposed by nineteenth century legislation’ (Accountancy, December 1960: 693). But doing so required them to take an alternative duty to report on internal control. The fundamental purpose of this study is thus to demonstrate that the auditors’ duty to report on internal control was introduced into BSA 1960 as a result of the policy exchange struck between the Treasury and the ICAEW over the modernized audit procedure.

There exists a substantial critical literature on the ‘professionalization’ of accounting which is featured by studies of closure strategies pursued by professional accounting bodies. Works of this genre principally focus on relationships – inter-organizational, inter-occupational and, particularly, state-profession – in the endeavour to offer a ‘coherent explanation of why some occupations (or segments) successfully become accepted as professionalized whilst others do not’ (Cooper and Robson, 1990, p. 374). Among them, many studies employ the analytical framework of corporatism to achieve a better understanding of interest-representation relationships between the accounting profession and the state in a particular geographic locale (e.g. Puxty et al., 1987; Cooper et al., 1989; Richardson, 1989; Willmott et al., 1992; Chua and Poullaos, 1993; Walker and Shackleton, 1995 and 1998; Stoddard, 2000; Rodrigues et al., 2003; Noguchi and Edwards, 2004). This study, though in the context of negotiations over the regulatory terms of audit procedure to be applied for building societies, provides additional evidence of political relationships formed between the UK accounting profession and the state authorities such as the Treasury and the Board of Trade (BoT). By so doing, it aims at adding to the series of literature employing the corporatist framework to examine close and dialectical relationships between the accounting profession and the state.

The reminder of this article proceeds in the following manner. The next section explores the corporatist theory as the basis to provide a possible rationale for the accounting profession negotiating with state authorities over the new regulatory term of BSA60. The importance of audit of building societies and the background of the establishment of BSA60 are reviewed in the third section, whereas the ICAEW’s request for reform of the Ninth Schedule of CA48 is examined in the fourth section. The following three sections present details of the negotiations between the ICAEW and the Treasury (including CRFS) over the audit procedure to be applied for the implementation of the regulations of BSA60. The response of building societies to the negotiations progressed between the accounting profession and state authorities are reviewed in the eighth section. The final section offers summary and concluding remarks.

**Corporatism**

‘Corporatist theory’ proposes a framework for the systematic study of the practice in which society is organized into specific legal forms (i.e. corporations) subordinate to the state. Schmitter (1979: 13) defines corporatism as:

>a system of interest representation in which the constituent units are organized into a limited
number of singular, compulsory, non-competitive, hierarchically ordered and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports.

Corporatism is seen as an institutionally structured system of interest representation, which operates in a manner that restricts competition and openness among organized interests. One of the features of the theory lies in its treatment of the state. The state is seen as an organizationally powerful entity able to pursue its own autonomous interests through its size, complexity and bureaucratic power. Under corporatism, the pluralist conception of widely dispersed power is negated, instead state institutions are regarded as ‘structured in a biased form...such that in mediating conflicts they automatically favoured certain interests over others’ (Williamson, 1989: 59-60, emphasis in original). Williamson (1989: 60) adds that:

The state, backed by considerable resources, authority and influence over ideas, could act to exclude or redefine threatening issues and to assimilate interests such that it was not a neutral set of institutions, but an ‘instrument’ of domination or class rule.

If the behaviour of other organized interests pose a fundamental challenge to the structural interests of the state, it seeks to change the behaviour of the groups. Arguing that all relations between the state and organized interests are not the same, Cawson and Saunders (1983: 16) raise a proposition called ‘dual state thesis’. Where targets of intervention are ‘interests constituted on the basis of their socio-economic function’, as seen in the domain of economic management or industrial policy, ‘the intervention has to be purposive-rational, this is justified in terms of effective results rather than legitimate procedures’, according to Cawson (1983: 179). If the state has a difficulty in securing such results by means of authoritative regulation, intervention into the socio-economic function requires the co-operation of the functional groups.

Groups called ‘producers’, representing sectoral business interests including professional and management interests, have fundamentally different resources of influence to wield of those of consumers or others. Producers can wield a range of sanctions (e.g. strikes, non-cooperation and refusal to provide essential information) and specialised skills and knowledge which raise serious obstacles to intervention by the state (Cawson, 1985: 12). The state in this case needs to enter into negotiations with producers in policy formulation in order to reconcile tension with the groups and to ensure effective intervention (Williamson, 1989: 125). Dual-state thesis therefore concludes that corporatism, as a mode of interest representation, is fundamentally limited to production politics (Cawson, 1983: 182).

In particular, professions seek to achieve ‘social closure around particular skills’ (Williamson, 1989: 172, emphasis in original) based on a body of specialist knowledge. Social closure means ‘the process by which social collectivities seek to maximize rewards by restricting access to resources and opportunities to a limited circle of eligibles’ (Perkin, 1989: 44). Professions use the ability to limit the supply of entrants into the professions and thereby maintain and, if possible, enhance their market and symbolic value. This creates the notion of professional autonomy, which suggests that professions come to have a legitimate right to determine what sort of and in what way their skilled services are supplied to their clients. Social closure affords the professional organizations significant power in terms of the demand and supply of the skilled
services. In any area where the state seeks to intervene into the skilled service of the professions, ‘it confronts this power based upon social closure’ (Williamson, 1989: 172).

Where professions are involved in providing services, much substance of the services is therefore:

determined not by those officially designated as ‘policy makers’, but by those professionals in return for cooperating with state policy...It is usually the case that, because of their central importance to the service, professions are formally designated places on official policy making bodies...Such extensive involvement of professionals in policy making and implementation is...in part legitimized by the professed altruistic or public-regarding ethos of professions. In part this entails ensuring that the requisite technical and ethical standards are upheld by members of the profession, although it should be added that the professions have a large say in setting these standards and an even larger say in applying them. (Williamson, 1989: 173-4)

Indeed, ‘members of a profession are licensed to carry out their occupation by relevant professional associations’, the monopolistic position of which is recognized in some way by the state in exchange for their own voluntary regulation over the behaviour of the members (Williamson, 1989: 171). Under the control, members are required to ‘act in an altruistic or public-regarding manner’ (Williamson, 1989: 171-2, emphasis in original). As Williamson (1989: 114) specifically refers to, ‘the example of accountancy raises the point that the professions are...likely to be prototypes for private interest government’.

In the sections that follow, we will trace the extended negotiations between the ICAEW and the state authorities such as the BoT and the Treasury over the modernized audit procedure to be applied for the implementation of the new regulations of BSA60. Before so doing, the background of the establishment of BSA60 is first reviewed in the next section.

**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 (Edwards et al., 1999). In fulfilment of these provisions a list of public auditors was drawn up in 1920 by the Treasury. The importance of this move did not go unnoticed, as was recognised in paragraph 110 of the Cohen Committee Report (1945) (Board of Trade, 1945: para. 110).

The same system of professional auditors was introduced to all UK companies through Section 161 of CA48, except ‘exempt private companies’ (CA48 also introduced some exceptions which included the clearing banks - see Billings and Capie, 2008). Section 161 further restricted eligible auditors in principle to the members of associations of accountants recognised by the BoT; prior to being part of the register, eligible auditors had to be members of either the Society of Incorporated Accountants and Auditors (SIAA); the Association of Certified and Corporate Accountants (ACCA); 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). Among the UK, the chartered bodies were granted a Royal Charter, ‘symbols or badges of honour that allegedly signify exceptional virtues and
trustworthiness in the provision of specialist expertise’ (Willmott, 1985: 47). As the result of this licensing, members of these bodies were placed in a dominant position’ in the accountancy labour market. In particular, the ICAEW had since its formation in 1880 been consistently the largest among the chartered bodies in number and thus the most powerful entity. In this sense, social closure formed around the ICAEW had been substantiated in both areas of audit of building societies and limited liability companies.

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 Societies 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 Bátiz-Lazo, 2006).

In this background, the State Building Society in 1959 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 (Accountant, 24 June 1961: 786). 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 others 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 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 suits of the Eighth Schedule of CA48, disclosure under BSA60 made specific requirements as to the items to be disclosed in the accounts of building societies. In addition, directors of a building society were explicitly required to maintain the systems of internal control (that ensured proper safekeeping of mortgage deeds). This system was deemed essential ‘to carry on the business of [a] society in an orderly manner, safeguard its assets and ensure the accuracy and reliability of its records’ (ICAEW, 1960: 7). As the highest and comprehensive standard for the information to be disclosed, the need to present a true and fair view was also stressed through BSA60, again following the same general requirement of CA48. Accordingly, auditors of building societies 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 general, and the accounts had been prepared to give a true and fair view.
In particular.

In case of limited liability companies, the form of the auditors’ report was prescribed in the Ninth Schedule of CA48. An inconsistency in the requirements of paragraphs 3 and 4 of the Ninth Schedule, however, had been blamed as the source of confusion of auditors’ comments (i.e. amplifications) from their qualifications (Kettle, 1954a: 250; 1954b: 284). The inconsistency was the requirement that auditors were to state in their report whether the accounts of a company, exempted from disclosing certain specific particulars under Part III of the Eight Schedule, still gave a true and fair view subject to the non-disclosure. The apparent inconsistency on the Ninth Schedule of CA48 resulted in the ICAEW informally approaching the BoT, the state authority competent for the administration of CA48, to negotiate the revision of the schedule.

Reform of the Ninth Schedule

In April 1951, the ICAEW submitted its memorandum proposing to revise the Ninth Schedule of CA48 to the BoT. The Ninth Schedule stipulated the following duties for auditors to state in the report:

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 form prescribed in general and the wording of the last paragraph in particular. Kettle (1954a: 248), President of the ICAEW in 1950-51, 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 members stemmed from the specificity with which they were required to word their report. In making the representation, the ICAEW indicated 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 further 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 example, were allowed to
hide the full extent of their reserves until 1970 (see Billings and Capie, 2008).13 In tune
with the sentiment of the time, Kettle (1954b: 284) expressed his concerns publicly:

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.

This concern stemmed from fear within ICAEW’s 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 BoT, the
ICAEW suggested to reform the form of the report by referring to the desirability for
greater clarity to be given in the report and restricting the truth and fairness of the
accounts of the exempted companies by adding the phrase of ‘…so far as is required by
the provisions of this Act applicable to the class of company concerned.’ (BT58/483: 18,
emphasis added)

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 regulations introduced into CA48
in general and the ‘true and fair requirement’ in particular. CA48 had 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 reform envisaged in CA48 was 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) and to achieve
the objective, the true and fair requirement was introduced as the comprehensive
regulatory provision.

The BoT gave its consideration to the ICAEW proposal to the extent that a member
of staff even prepared a draft note entitled ‘Companies (Accounts and Audit) Amending
Bill’ to amend CA48 in relation to accounts and audit (BT58/483: 12). But no further
action was taken (BT58/483; Noke, 2007: 181) and so was noted to the ICAEW,
informing them that the issues raised would be taken for consideration on occasion of a
future revision of CA48.

One of the setbacks that impeded the BoT’s action at this stage was the request
made in May 1952 by the UK accounting profession themselves, composing the three
chartered bodies, the SIAA and the ACCA, for amendments to be made to section 161
of CA48. In a letter jointly signed by the president of each body, it was stated that
exempted private companies should have their accounts audited only by members of those bodies (BT58/603). The same letter added that the BoT, with the opportunity of amending section 161, could make other amendments together to the accounts and audit provisions of company legislation (BT58/603; Noke, 2007: 179). However, the accounting profession’s proposal to amend section 161 was regarded by the BoT as a ‘drastic and far reaching one’ that ‘would in effect close the door in future to “unqualified” accountants who wish to start up in practice, so far as the audit of accounts of companies is concerned’ (BT58/603). In the next section, we reveal how the ICAEW revived its initiative to change statutory audit requirements by co-operating with the CRFS concerning the content of friendly society accounts published to comply with Form A.R. 11.

**ICAEW and CRFS**

In spite of the BoT’s dismissals in 1951-52, discontent amongst members of the ICAEW continued and was even voiced publicly as the quotes from Kettle above suggested. The ICAEW’s manoeuvring then re-started when the Parliamentary and Law (P&L) Committee of the ICAEW Council examined, at its meeting held on 26th November 1956, a letter from an accounting firm, Jeffrey’s, Alfred Henry & Marks, requesting an inquiry on the ‘statutory wording of the certificate required to be given on the accounts of a friendly society’.

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’ 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. Moreover, the form of the auditors’ report on the accounts of building societies was requested to be dealt with as ‘a matter of urgency’.

At the time, financial disclosure of building societies remained under the influence of nineteenth-century legislation. Edwards and Chandler (2001: 209) regarded the regulatory provisions for accountability introduced for friendly societies, building societies and industrial and provident societies had been based on the concepts of paternalism and financial safety. 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). In fact, the regulation of the audit of building societies placed greater emphasis on ‘fraud detection’ and for the purpose of safeguarding the assets of a building society, the auditors, rather than the directors, had 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 modernize the antiquated form of the auditors’ report on the accounts of building societies, in lieu of the failed attempt to reform the Ninth Schedule of CA48 in 1951-52. Through the process, the ICAEW attempted to introduce what they regarded as an ideal form into the auditors’ report of building
societies, perhaps as a showcase of what could be (and needed to be) done in company legislation.

The T&R Committee on 21st 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. A memorandum was submitted to a meeting of joint representatives of the P&L and T&R Committees held on 3rd October 1957. 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.” 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’ 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, 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’. Shortly after, it was agreed at a meeting of the P&L Committee on November 25th 1957 that, based on the memorandum already prepared, ‘an informal approach be made to the Chief Registrar of Friendly Societies’. 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.

A meeting with the Chief Registrar, Sir Cecil Crabbe, and his officials was held on 13th December 1957. At 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) and the Notes for the Guidance of Auditors’ for which CRFS had power to prescribe. Rather than going along with the ICAEW’s original plan to reform the wording of the auditor’s report, the CRFS counter-proposed by first amending Form A.R. 11. At its meeting of December 30th 1957, the P&L Committee decided to accept the Chief Registrar’s offer and so instructed the ICAEW representatives.

A second meeting with CRFS was held on January 3rd 1958. The discussions included the possibility of introducing changes to Form A.R. 11 by enacting them through new legislation. Following the meeting with CRFS, the question of investments was specifically discussed within the P&L Committee on February 24th 1958, and 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’.

Following further exchanges with the ICAEW representatives, in December 1958 the CRFS once again invited the ICAEW to reconsider revisions so far made to Form A.R. 11. This new set of changes had been motivated by a statement made by Sir
David Eccles, President of the BoT, in the House of Commons on November 26th 1958. The purpose of Eccle’s statement was to inform the House that ‘the Chancellor of the Exchequer intends to introduce legislation concerning building societies during this session’. The legislation was indeed enacted in June 1959 as the House Purchase and Housing Act 1959. This piece of legislation 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 Bátiz-Lazo, 2006). In preparing the new Act and perhaps in the expectation that trustee status would fuel further growth of mortgage advances by building societies, the Chief Registrar at the stage of December 1958 decided to once again revise financial disclosure required for building societies and ‘lay [a completely new Form A.R. 11] before Parliament’ and for that purpose ‘sought the views of the Institute on the proposed new form’.34

During the meeting of December 29th 1958, the P&L Committee arranged to forward the new draft of changes to the T&R Committee for comment. At the same time, the P&L Committee formed its own sub-committee, which would scrutinize and report on the response from the T&R Committee.35 This draft then became the basis for ICAEW’s communication to CRFS made in May 1959.36 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’.37 The report of the P&L Committee dated May 25th 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)38

Staff at the CRFS then prepared a draft of the new ‘Notes for Guidance in completing Revised Form of Annual Return’ and forwarded it to the ICAEW, which returned their comment as requested. As a reply, the CRFS expressed the view that ‘these comments [of the ICAEW representatives] were substantially acceptable to the Registrar’.39

ICAEW and the Treasury

On September 28th 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. (The Times, 28 September 1959: 14)

As the quote above suggests, 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 CRFS and ICAEW were already looking at the case of reforming disclosure requirements of building societies. Indeed, ‘in view of a recent public indication that amendment of the legislation affecting building societies was under active consideration by the government’,40 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’. The P&L Committee at the same time 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’. By October 26th 1959, the Treasury had acknowledged receiving the communication and said to be ‘considering the [Institute’s] request’.

Without delay in October 22nd 1959, the T&R Committee formed an ad-hoc sub-committee to prepare and forward a memorandum to the P&L Committee. The memorandum was examined by the P&L Committee 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’. The Council approved the document on December 2nd 1959.

Explaining the background of the extended contact between the ICAEW and CRFS since November 1957, the memorandum stressed that ‘there has been a marked improvement in the form of A.R. 11’. The memorandum then explained the fundamental reason for reforming the regulation of the accounts and audit of building societies as based on the need for ‘…adequate disclosure of the use made of [individual society’s] funds and the state of its affairs’ (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)

As the qualification of the auditors, the position of the ICAEW was clearly stated in the memorandum that:

A person should not be permitted to be appointed auditor of a building society unless he is a member of a body of accountants recognised by the Board of Trade for the purposes of Section 161 (1) (a) of the Companies Act 1948. (P&L Committee Minutes Book I: 28)

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:

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)

Based on these recommendations, the memorandum specifically added 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)

These proposals to reform the form of the auditor’s report were the same to those put forward to the consideration of the BoT in April 1951.49 In this submission to the Chancellor of the Exchequer, the ICAEW 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 cooperation with the CRFS since 1957 in helping to improve Form A.R. 11. A letter dated October 14th 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 [their 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 5th 1960 for a meeting between representatives of the ICAEW, Treasury officials, the Chief Registrar and CRFS staff to discuss the ICAEW memorandum.50 ‘The Treasury officials and the Chief Registrar were in general agreement with the proposals in the memorandum and would include most of them in their submission to Ministers’, said the minutes of the meeting (T233/1652). In fact, the Treasury and the Chief Registrar from the outset intended to bring building societies legislation ‘up-to-date’ (BT58/831) and, for this purpose, take ‘similar lines to improvements made in company law’ (BT58/831).51 The ICAEW proposal that incorporated relevant accounting and auditing requirements of CA48, such as the true and fair requirement, was therefore in alignment with the state interest and thus seen as acceptable for the government authorities.

That of January 5th 1960, was the first meeting which formally included representatives of not only of the ICAEW but also of the Building Societies Association.52 However, A. Mickle, Managing Director of the Woolwich Equitable and Chairman of the Building Society Association, reported back to his council that

because of the constitutional position [C. G. Garrat-Holden, the Secretary of the Council and I] were required to give promises that we would not disclose what transpired at the meeting, but [I am] authorised to inform the Council that such meeting had taken place, on the understanding that the members would not disclose this information to anyone else. (BSA Agenda Papers vol. V, 14th January 1960: 549)

Building societies were thus kept on the margins of the joint meeting as their representatives kept the contents very private.

To amplify several points that the Treasury had reservations at the first meeting, a second meeting between the Treasury, ICAEW and CRFS followed immediately in February 22nd 1960. In a supplementary memorandum (dated 7th January 1960) prepared for the second meeting, the ICAEW re-emphasised the need to reform the form of the auditors’ report of building societies 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 tithe the responsibility that the auditor is capable of accepting. (T233/1652)

The ICAEW 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 were ultimately adopted as standards for building societies following the repeated appeals of the ICAEW. 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 2nd December 1959 and amplified in the supplementary memorandum dated 7th 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 by H. A. Benson, Chairman, to the P&L Committee on 28th March 1960. 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’. The report of the sub-committee was submitted to the P&L Committee on 25th April 1960, which stated that ‘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’ (P&L Committee Minutes Book I: 120). A further report prepared by the Deputy Secretary of the ICAEW, F. M. Wilkinson, about subsequent amendments made to the Bill during the Committee Stage in the House of Lords was presented at a meeting of the P&L Committee held on May 23rd 1960, 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…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)

At the same time that 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)

Audit of Internal Control

In spite of the success claimed by *Accountancy*, chartered accountants were unable to completely break free from their ‘nineteenth century shackles’. In the first memorandum submitted to the Treasury (dated 2nd December 1959), the ICAEW 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: 27)

On this proposal, a note (dated 8th January 1960) prepared by J. M. Bridgeman at the Treasury of the first meeting held on January 5th 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, emphasis added)

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 on this point, amplifying its original proposal. But Bridgeman’s note 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, emphasis added)

In the supplemental memorandum dated January 7th 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, however, 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, emphasis added)

This is a clear expression of professional autonomy, on which professions are regarded as having a legitimate right to determine what sort of and in what way their skilled services are supplied to the clients. As indicated in previous sections, members of the ICAEW, taking advantage of the system of professional audit, had long and almost dominantly engaged into the audit of the accounts of building societies. Based on this powerful position, they had come to independently change the original interpretation of the regulatory terms provided in the Building Societies Act 1894 in applying it in practice in accordance with the development of modernized audit procedure. Indeed, the following reminiscence by an auditor, Parry Goodwin, partner of Baldwins, about a typical audit in the 1920s, substantiates the claim of the ICAEW that auditors of building societies had come to alternatively adopt testing procedure for a portion of mortgage deeds at least as early as the 1920s:

We went out with a fairly detailed audit programme and started by sampling or checking or verifying. If you were doing a building society, you’d take the respective areas, the deposits, the share holdings, the mortgage advances, the investments, or a proportion of them. They’d call the pass-books in very often and you’d inspect a proportion and send out audit letters to members asking them to contact you if they didn’t agree the balance. You’d look at the certificates for investments that the society held. You’d get letters from solicitors who were holding deeds. You’d inspect a proportion of the deeds of the mortgaged properties, and you’d look to see that the mortgage deed itself and the title deeds were in order. (Matthews and Pirie, 2000: 21)

Before holding the second meeting with the ICAEW representatives, the Treasury and CRFS were prepared to accept the ICAEW 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 26th January 1960)

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

(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
On February 22nd 1960, the second meeting took place between the Treasury (including CRFS) and the ICAEW, in which the content of the ICAEW supplemental memorandum was examined. 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 position of the ICAEW. The Chief Registrar, Sir Cecil Crabbe, though privately, deplored the loss of the auditors’ duty 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. (doc 2 in T233/2095 - Memo from Chief Registrar [Sir Cecil Crabbe] to Treasury [F. E. Figgures]–dated 29th February 1960)

However, in exchange for the substantial concessions made to the ICAEW, the Treasury and CRFS were firm on opposing to any reduction of the responsibility of auditors and instead requiring them to take an alternative duty to report on internal control. This was on the ICAEW side immediately reported back to the P&L Committee of the 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 further 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’ on this matter. The P&L Committee then requested the T&R Committee ‘to prepare…a draft auditing statement relating to building societies’. The T&R Committee appointed an ad hoc sub-committee for this purpose and, at a meeting of joint representatives of T&R and P&L Committees held on April 8th 1960, matters to be dealt with in the proposed statement 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)

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… (Accountancy, April 1960: 395)

Adding about the duty of auditors:

…the scope [of the auditors’ report] 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)

Some of the district societies (including the London & District Society) of the ICAEW voiced their opposition to the issuance of the guidance statement of the audit of building societies for it being needlessly restrictive and patronizing. Against the opposition and to ensure the implementation of the auditors’ new duty to report on internal control, the P&L Committee had to re-stress 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’.62

The ad-hoc T&R sub-committee prepared and submitted to the T&R Committee a memorandum,63 which was then amended in some points at a meeting of joint representatives of T&R and P&L Committees held on October 20th 1960. Changes were also made for the document to be 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 1960.64 The P&L Committee scrutinised the revised memorandum and the Council finalized the document for publication ‘as a statement for guidance on the audit of building societies accounts’ on December 7th 1960.65 In the document entitled 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, 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)

The Accountant (24 December 1960: 793) 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 proposal, relieved them from ‘the shackles imposed by nineteenth century legislation’ (Accountancy, December 1960: 693) to inspect all mortgage deeds but, in exchange for this, the accountants were required to take an alternative duty to report on internal control.

Modifying Autonomous Interest

In this section we review the response of building societies to the negotiations progressed between the accounting profession and the state authorities over the procedure to be applied for the audit of building society’s accounts. Evidence presented so far above suggests building societies themselves were largely marginalised from discussions leading to the reform of building society legislation. However, J. R. Millican, General Manager and Secretary of the Cheltenham & Gloucester and Deputy Chairman of the Building Societies Association in 1959 and Chairman from 1960 until his untimely dead in 1961, claimed that BSA60 resulted from a long process of consultation and, he emphasised, this was contrary to other experiences of new legislation dealing with building societies.66 According to Millican, the council of the Building Societies Association had begun examination of existing law in 1954 and by December 1957 they were in a position to put their proposals before the government.

Millican’s statement implies the possibility that the Building Societies Association might have been (informally) aware of the dealings between the ICAEW and the CRFS. There is some evidence that the council of the Association was not totally unaware of developments. For instance, during an interview with staff of the CRFS on March 9th 1956, the latter enquired with one of councilors of the Association about the desirability of aligning financial statements of building societies to the Ninth Schedule of CA48. Specifically, of changing the wording of the audit report for the reason that the ‘present audit certificate was…giving a loophole to unsound societies’.

However, the voice of the Building Societies Association remained silent on this matter and certainly failed, if any, to impact upon the cooperative discussion on the revision of Form A.R. 11 progressed by the ICAEW and the CRFR between 1956 and 1959. This was noted by P. A. Pack, auditor of building societies and regular contributor on the matter of financial disclosure to the Building Society Gazette (e.g. see August, 1959: 658), who in the November issue of 1959 reported that:
In conclusion I must say I was surprised to find [in the guideline of the latest version of Form A.R. 11] that the auditors [of building societies] are still not required to report whether or not in their opinion the account and statement gives a ‘true and fair view’ of the society’s affairs….

(Building Society Gazette, vol. XCI, 1959: 864)

Pack’s view concurred with that of R. Cowling (December: 996), who publicly complained that the BSA learned of the legislative amendments when the Bill ‘was very far advanced in draft’. Indeed, a new version of Form A.R. 11 and abbreviated accounts were formally put to consideration of the Building Societies Association until June 1960. Pack’s view was also consistent with the fact that it is until the opening of the consultation process when references emerge to written representations made by building societies: namely, memoranda to the CRFS from the Building Societies Association (December 9th 1959) and the Halifax (December 19th 1959), then the biggest society in terms of assets (at the time a non-member of the Association).

However, as to the concession made by the Treasury and the CRFS over the issue of the auditor’s duty on the inspection of mortgage deeds (examined in the previous section), of importance was the fact that ‘The building society associations and the chartered accountants are agreeable’ (BT58/831) on the new regulatory term. The Treasury had agreed with the Chief Registrar, before holding the second meeting with the ICAEW on February 22nd 1960, that ‘it would be helpful to have a round table meeting with the Building Societies Association and the Institute of Chartered Accountants about the duties to be imposed on auditors and the form of the auditors’ certificate’ (T233/2095: 23). A letter of invitation sent to the council of the Building Societies Association recorded that:

We think that the best way of making progress on this particular point [the responsibilities of auditors and the form of certificate which they are required to sign] would be to sit round a table with representatives of your Association and of the Institute to discuss it…It would almost certainly be of great value to the discussion if we could have the benefit of the advice of one or two auditors who have wide practical experience of auditing Building Societies accounts.

(T233/2095: 24)

The Association’s official position, when drafting its ‘model rules’ (i.e. ‘best practice’ guidelines), was that the auditors should ‘inspect the mortgage deeds and other securities belonging to the Society’70, but they themselves, nor their advisory auditors with the practical experience of auditing building societies accounts, raised no objection to the ICAEW proposal to abolish the auditors’ duty to inspect all mortgage deeds at the second meeting. In fact, evidence in the Appendix available in the form of articles dealing with BSA60 published in Building Societies Gazette suggest that changes to Form A.R. 11, the form of the auditor’s report and internal procedure to control mortgage deeds were not in any way a major source of concern for the Building Societies Association nor for individual societies.

Rather, as revealed in a further document of the Treasury, the Halifax Building Society was proposing, in its memorandum dated 19th December 1959, that ‘The requirement to inspect all mortgages annually should be modified’ and ‘Instead obligations similar to schedule 9 of the Companies Act should be imposed’ (T233/1652, emphasis in original). In fact, the Halifax seemed to have the same view as ICAEW and was supportive of removing the auditor’s duty on the inspection of all mortgage deeds. Membership of a largest building society, such as the Halifax, already ran to several thousands at the time81 and inspecting all mortgage deeds each year would have been
too time-consuming and substantially increased costs of external audits. Similar views were also illustrated in the Appendix by A. Miekle of the Woolwich Equitable, the fourth largest and Chairman of the Building Societies Association (February, 1960: 117), J. R. Millican, (June, 1960: 452) and B. Whycherley of the Abbey National, the second largest in terms of assets (November, 1960: 900). Moreover, as the following quote suggests, when the Building Societies Act was enacted and also considering changes in operation resulting from the new legislation, directors of the Halifax were satisfied with their own system of internal control of mortgage deeds that had been established before the enactment of the Act:

The Act requires a Society to establish and maintain a system to ensure the safe custody of all documents of title and of deeds belonging to the Society or relating to property mortgaged to the Society. The Act further provides that a Society shall not be deemed to have established such a system unless on each occasion on which such document of title is released from the custody of officers of the Society consent is obtained of the Board of Directors or of a person authorised by the Board of Directors to give such consent. The present usage of the Society which will be continued and under which records of all outgoing and incoming deeds and documents are kept, is fully adequate to comply with this requirement of the Act…. (HBOS Minutes vol. 19, 7 September 1960: 1086)

This revelation indicates that at least some of the largest building societies, such as the Halifax, were already at the time of 1960 able to undertake the responsibility to establish and maintain proper records of, and the system of internal control over, the mortgage deeds and other assets, independently of the auditors’ inspection function.72

If the Halifax’s view was different to that of the ICAEW, the Treasury and the CRFS might not have made the concession to the accountants. But judging from the content of their December 19th memoranda, the Halifax’s case should have provided a strong case for the ICAEW proposal to remove the auditor’s duty to inspect all mortgage deeds. It is more likely that poor internal control of mortgage deeds was typical of smaller and/or ‘provincial’ societies – as was the case of most of the 46 societies outside of the Building Societies Association. The ICAEW themselves asserted in its supplementary memorandum dated January 7th 1960 that ‘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’ (T233/1652). The ICAEW on this respect specifically added that its Council considered that ‘a statutory obligation [for the directors of building societies] to do so would have a salutary effect…in the event of difficulties being experienced’ (T233/1652).

One is then only left to speculate why the CRFS was eager to keep the inspection of mortgage deeds. According to the Chief Registrar, Sir Cecil Crabbe, by the reform realized through the establishment of BSA60,

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 [F. E. Figgures]– dated 29th February 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… (doc 2 in
The sentiment made by Crabbe is understood as a faithful expression of their autonomous interest then and underwrite the argument that the traditional accounting and auditing regulation of building societies was constructed based on the concept of paternalism, as Edwards and Chandler (2001: 209) suggest.

A further possible factor that amplified the CRFS’s interest to keep the status quo in inspecting mortgage deeds was the fact that that its own staff was not certain of to what extent the control of mortgage deeds was properly implemented in practice. The following extract from a BoT memorandum dated March 18th 1960 concerning an inquiry from the Treasury underwrite this fact:

Mr. Bridgeman telephoned me at some length…The question was also raised as to the extent to which the legal obligation could be laid on building societies not merely to keep proper books but to ensure that books have in fact been kept properly. This was one of the many points which apparently had been raised by the accountancy representatives when they had an interview with the Treasury some time ago with suggestions for this legislation [BSA60]. A good deal of their recommendations appear to be incorporated in Clause 41. (BT58/831)

On the other hand, it is also apparent that this information asymmetry between the CRFS and the ICAEW concerning the practical actuality of the inspection of mortgage deeds implemented by individual societies caused the CRFS and the Treasury to be placed in a weak position in negotiating the terms of the inspection with the ICAEW. As Cawson’s Dual-state thesis (1985: 12) suggests, the profession association, such as the ICAEW, can wield a range of sanctions including monopolization of essential information for the state to effectively intervene into the domain of the skilled service of the professions. For this reason, the state authorities, as represented by the Treasury and CRFS in case of this study, needs not only to enter into negotiations with producers, but also make concessions to the group to ensure the effective intervention (Williamson, 1989: 125).

However, the unilateral concession was regarded as too harmful to the state interest to provide a paternalistic safeguard for the benefit of small investors of building societies. In fact, the Treasury and CRFS were opposed to any reduction of the responsibility of auditors of building societies (T233/1652). To maintain a balance between their autonomous interest and the concession made to the ICAEW, the state authorities had to amend its original set of policies by requiring the accountants to take an alternative duty to report on the nature and quality of internal control of the building societies.

Summary and Conclusions
This article aimed 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, we proceeded while being theoretically informed by the corporatist framework, to examine a series of negotiations between the ICAEW and the state authorities such as the Treasury (including CRFS) and BoT over audit procedure to be applied for the implementation of the new regulations of BSA60.

Interestingly, individual building societies and their association were less active in
participating into the extended negotiations on this issue. Failure to make effective representation of building society interests was surprising because the Building Societies Association was very active in representing its members’ interest during the drafting of the other piece of building society legislation, as the body to manage the agreement restricting 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 CA48, the ICAEW in April 1951 proposed to reform the Ninth Schedule of CA48, but at the time the BoT could not bring the issue on the reform agenda, because another issue concurrently raised, i.e. the proposal to amend section 161 of CA48, was at the time regarded by the BoT as a ‘drastic and far reaching one’ (BT58/603). But dissatisfaction amongst the ICAEW membership remained.

In 1956 the ICAEW once again made representations on behalf of its members when the P&L Committee decided to approach the CRFS. The intent was to break with what was considered as an outdated practice and to replace it with a more ‘modernized’ form of the auditors’ report for the accounts of building societies. The ICAEW took advantage of the opportunity to co-operate with the CFRS in improving Form A.R. 11, as a way to legitimize its own view and, in due course overstepping the CFRS, ‘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.73

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 procedure, the ICAEW undertook to ‘issue to members a statement for the guidance of the auditors of building societies’.74 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).

In the context of negotiations over the regulatory terms of audit procedure to be applied for building societies, this research provides further evidence of the corporatist relationships of the UK accounting profession with the state authorities. By so doing, the study aims to add to the series of systematic studies employing a corporatist framework to examine close and dialectical relationships between accounting profession and the state. Specifically, research in this article provides further support to the view that the corporatist relationship of the ICAEW is applied not only to the BoT, but also the Treasury (including CRFS), in which the interest of the ICAEW to modernize the audit procedure was in opposition to the Treasury attaching a greater importance to the auditors’ paternalistic duty to safeguard, on behalf of the directors, the assets of building societies for the benefit of small investors. Facing the ICAEW’s professional autonomy to determine what sort of and in what way their skilled services are supplied to their clients, the Treasury and CRFS had to make concession to the interest of the accountants to reconcile the tension.
The Act of 1960 in this way relieved chartered accountants from the ‘out of tune’ (T233/1652) practice established by nineteenth century legislation in which the auditors had been expected to safeguard the assets of the building societies, in lieu of directors, and inspect all the mortgage deeds in custody of the society as well as other securities in which deposits had been invested. However, in a policy exchange struck between the Treasury and the ICAEW over the new regulatory term of BSA60, the auditors were then set in position to take the alternative duty to report on the nature and quality of internal control.

Recently, Section 404 of the Sarbanes-Oxley Act in the USA required auditors to report on management’s internal control review. This requirement was introduced in response to instances of fraudulent reporting or misstatements exposed in the cases of Enron and WorldCom, i.e. for the objective of ‘statement verification’. In contrast, the duty of auditors to report on the system of internal control introduced in Britain by the Building Societies Act 1960 was, as illustrated in this research, enacted in a completely different context, i.e. an alternative form of audit that still emphasized the objective of ‘fraud detection’ (Chandler et al., 1993:446; Kitchen and Parker, 1980: 55; and Lee, 1977: 98).

Postscript: Reform of the Ninth Schedule Revisited

On December 10th 1959, Reginald Maudling, the President of the BoT, 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’ (Board of Trade, 1962: 1).

The BoT itself submitted its own evidence to the Jenkins Committee, in which it specifically stated that ‘Exempt private companies are not obliged to appoint properly qualified auditors, mainly because it was thought that otherwise the strain imposed on the accountancy profession would be great’ and that ‘The Board have…[now] suggested that the position of exempt private companies in this respect should be reconsidered’ (BT58/727). The BoT further indicated in its evidence that:

(ii) The form of auditors’ report required by Section 162 in conjunction with the Ninth Schedule has been much criticised to the Board of Trade as being over elaborate and too complicated for reading before the company in general meeting. The [Jenkins] Committee may wish, therefore, to invite evidence on this point from those interested and to consider whether simplification is possible without impairing the value of the report to the members. (BT58/727, emphasis in original)

Accordingly, submissions were made by the accounting profession, including the ICAEW. As to the form of the auditors’ report, the ICAEW memorandum dated March 17th 1961 followed the same line of thought made earlier in April 1951. The March 1961 communication proposed revising the Ninth Schedule in the following way:

(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
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)

The Jenkins Committee examined the issue of exempt private companies in general,
and the exemption allowed to them in respect of auditors in particular, and concluded
that:

In the evidence we have received about the exempt private company there has been very littl e
support for the maintenance of the present exemptions in respect of auditors…There is general
agreement…that the accounts of all companies should be audited by accountants qualified under
section 161 (1)…We see no good reason for continuing the distinction between exempt private
companies and other companies… (Board of Trade, 1962: 20)

The BoT therefore at the stage in the 1960s conceded to the accounting profession,
who had since the 1950s requested that exempted private companies should be required
to have their accounts audited only by members of those bodies (BT58/603), by leading
the Jenkins Committee to conclude the overall withdrawal of the exemptions that had
been permitted to them under CA48. Furthermore, the Jenkins Committee, again
following the BoT’s suggestion and accepting the ICAEW submission as it was,
recommended the reform of the Ninth Schedule as follows:

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 nor 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)75

The ICAEW’s original wish to reform the Ninth Schedule found its final outlet in
the Report of the Jenkins Committee and realized through the reform enacted as the
Companies Act 1967. However, in addition to the reform of the Ninth Schedule
(indicated as (ii) in the evidence above), the BoT had originally suggested to the Jenkins
Committee one further point that needed to be reformed, which was stated in the
evidence as follows:
With regard to the functions of auditors the Board of Trade hope the Jenkins Committee will recommend on the following two points:

(i) Auditors are required to state in their Report whether proper and adequate books of account have been kept by the company (paragraph 2 of the Ninth Schedule). The extent to which auditors should go behind and check the books of account, and the extent to which they may accept directors’ certificates, are to some extent governed by case law and professional codes. But there is no uniformity of practice and it is for consideration whether the duties of auditors in this regard should be clarified in the Act. (BT58/727, emphasis in original)

This suggestion was not adopted by the Jenkins Committee, but restored by the BoT itself and incorporated into the Companies Bill in its drafting stage (BT281/179). Indeed, subsection 4 of section 14 of the Companies Act 1967 increased the duty of auditors by stipulating that:

It shall be the duty of the auditors of a company, in preparing their report under this section, to carry out such investigations as will enable them to form an opinion as to the following matters, that is to say, -

(a) whether proper books of account have been kept by the company and proper returns adequate for their audit have been received from branches not visited by them; and
(b) whether the company’s balance sheet and (unless it is framed as a consolidated profit and loss account) profit and loss account are in agreement with the books of account and returns.

The chartered accountants were thus finally relieved from the duty to state their opinion in the form originally prescribed in the Ninth Schedule of CA48 that had since been regarded as ‘over elaborate and too complicated’ (BT58/727) and possibly misunderstanding (Board of Trade, 1962: 167) but, again in exchange for this, the BoT, through the provision stipulated in the Companies Act 1967, required them to indispensably investigate whether proper books of account have been kept by the company, so as for them to form an opinion on this specific matter.
Appendix: Reaction of Building Societies to BSA60
(Articles dealing with the Building Societies Act 1960 published in the Building Societies Gazette between January and December 1960)

<table>
<thead>
<tr>
<th>Date (page)</th>
<th>Title, Author</th>
<th>Comments/Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>January (11)</td>
<td>New Building Society Legislation, Parliamentary Correspondent</td>
<td>Advises new building society legislation will be introduced (which need not need to wait for the results of the Jenkins Committee). Aim is to protect savings from unsecured loans.</td>
</tr>
<tr>
<td>(40)</td>
<td>Light on the Provisions of New BS Legislation, Extracts of article in The Times (8 Dec 1959)</td>
<td>It is much welcomed that the new Bill will limit mortgage advances for commercial property. This will deter practice in the future but some provision must be made for societies with an already large portfolio of commercial loans.</td>
</tr>
<tr>
<td>(62)</td>
<td>Annual Meeting of Woolwich Equitable, Sir Thomas Spence, Chairman.</td>
<td>Welcomes any new legislation that will ‘secure the high standards’ to those outside of the Building Society Association (like the London).</td>
</tr>
<tr>
<td>February (117)</td>
<td>Association Press Luncheon, Alexander Miekle, Chairman of the Building Society Association and GM Woolwich Equitable</td>
<td>Amending Legislation – The Building Society Association welcomes new legislation but hopes that provisions that will ensure the ‘traditional function’ of bs will not be used for other purposes. ‘Mr Miekle was sure that the new Act would not interfere in any way with the existing workings of a reputable society’.</td>
</tr>
<tr>
<td>March (169)</td>
<td>Desirable and Practicable?, Discussion of a ‘recent article in the Economist’.</td>
<td>The new legislation should take steps to dissolve the interest rate cartel set up around the Building Society Association.</td>
</tr>
<tr>
<td>May (366)</td>
<td>Building Societies Bill, 1960, Correspondence</td>
<td>J.M. Roberts; V.C. Donaldson; A.V. Page – Comments disapprovingly on directors, managers and secretary no longer able to assess the quality of security. Strongly objects to this clause (Clause 13-1). Hy. Clutterbuck – Thinks the new Bill is ‘red tape’.</td>
</tr>
<tr>
<td>(393)</td>
<td>Building Societies Bill, 1960, Memorandum submitted by the City of London Building Society to the CRFS and the Building Society Association</td>
<td>1) Add flexibility to Clause 1 (b) and (c) so that the CRFS can adjust the limit of advances of £5,000 or over that require a qualification by auditors in Part I - AR 11. 2) Objects to Clause 13 (1)</td>
</tr>
<tr>
<td>June (452-8)</td>
<td>Building Societies Bill, discussion during the annual conference led by Mr J.R. Millican, Deputy Chairman of the Building Society Association</td>
<td>1) On the eve of its third reading in the House of Lords, Mr Millican was reported as stating that ‘there was no hasty or panic measure resulting from the publicity given to [the Jasper Affair]’. 2) Reassures that the main aim of the Bill is to protect the small investors but societies proceed segregated because they had their own separate code of legislation.</td>
</tr>
</tbody>
</table>
3) Other of the main effects of the Bill is to ‘ensure proper standards of accounting and audit were maintained, so that investing in members might obtain a proper view of their society’s activities.’

4) To give greater powers to the Chief Registrar when dealing with a society which got into difficulties or abused its position.

5) Acknowledged that ‘Clause 13 had caused more comment and criticism than any other, because it directly opposed what had been a regular practice in some of the smaller societies.’ He stated that although wording had changed from the first draft, principle remained that ‘all valuations must be made by an independent person’. The majority of the Council was supportive of this principle.

(490-1) The Building Societies Bill, Summary of the debate during the committee stage

1) Detailed discussion as to the pros and cons of Clause 13.
2) Clause 11 – lending of money between societies.
3) ‘Various other resolutions were made about special resolutions, the auditor’s report and … [other]’.

July An Inadequate Report, Editorial

‘The wisdom of refusing to allow the publication [in the Gazette] of any views [during the Annual Conference of Building Society Association] except those expressed from the platform regarding the new Building Societies’ Bill is also open to question. This far reaching measure of vital importance … It is also being rushed through both Houses of Parliament with almost indecent haste. Under the circumstances members undoubtedly felt that the conference afforded the first and the last opportunity, which they were likely to get, of making their opinions known to and of bringing pressure to bear on not only the Council but on the Government itself.’

(557) The Building Societies Bill, A review of the debate during the second reading in the House of Commons

The Chancellor met directors of building societies and responded to ‘constructive’ criticism, which suggested the new Bill gave excessive powers to the CRFS.

Discussion with the Chancellor and Mr Barber on the possibility and desirability of overseas operations.

Discussion around Clause 14 (formerly Clause 13).

August The Bill in Committee, Anonymous

The Bill has passed its Report Stage, received its third reading in the House of Commons and its Royal Assent.

Congratulations to Mr Barber, Economic Secretary and the Government’s principal spokesman, for listening to arguments on all sides in the Standing Committee. He approached his task in a conciliatory spirit.

Dissatisfaction remains with Clause 14, the method to appeal the decisions of the CRFS (i.e. excessive powers) but happy that
Summary of proceeding of the Standing Committee on the Building Societies Bill. Items included

1) Debate on the limit of non-special advances fixed at £5,000;
2) Exceptions for houses built for letting;
3) Formation of new societies;
4) Procedure to appeal the new powers of the CRFS;
5) Use of surplus funds;
6) Clause 14;
7) Regarding a list of members in arrears, ‘Mr Barber agreed that under the Bill any member would be entitled to see the annual return…, but pointed out that in practice few members of a society would ask to see the annual return.’;
8) ‘Mr Bruce Millan expressed himself dissatisfied with the provisions in the Bill relating to the appointment and removal of auditors … he did not think that the Bill gave the auditor sufficient protection. Sir Keith Joseph pointed out that three Clauses in the Bill sought to strengthen the auditor’s position and to make it more difficult for a society to get rid of him if he were embarrassingly efficient. These Clauses followed very closely equivalent provisions in the Companies’ Act. One important safeguard was that if it were indeed to move to resolution not to reappoint the auditor, the notice of the meeting must include information that such a resolution was to be moved.’;
9) Advances to directors;
10) Investment in equities;
11) Operation of societies in the Commonwealth overseas.

F. P. Dilkes comments on the memorandum prepared by the St Andrew’s regarding special advances, liquidity ratio and register of members. Praises changes to Clause 14 (formerly 13) in the last draft.

Jones, Lang, Wotton & Sons comments on overseas operations.

Discusses the change of word form of the auditor’s report in Clause 35 and its link to Section 149 (1) of Building Societies Act 1948. Lengthy discussion on the subject of revaluation of fixed assets. Distinction between revenue and capital reserves; their impact on liquidity. Accounting for taxation.

The new Bill tells how rapid growth of the movement ‘has been paralleled with an extension of bureaucratic controls’. Discusses the failed attempt to introduce a formula for purchase-to-let advance by the Opposition (i.e. G.R. Mitchison, a Tory MP) at the Committee Stage.

A.V. Page – Discusses Section 11 (investment of surplus funds) and the absurdity of measuring investments in War Bonds at book value rather than at their market value.

R. H. Coleman-Cohen (Alliance Building Society) – regrets the
Council was ‘unable to state the case on clause 14 in respect of their original recommendation, which resulted in their overwhelming defeat at the conference, and a consequential weakening of their status.’

In discussing that long years of controlled rents and housing restrictions, it considers that ‘... there will be an increasing market for good flats in the suburbs and beyond them. In both directions, there seems scope for building societies to expand. The interest of the Government and the movement in this respect are so similar that we hope that the Building Society Association will continue the consultation with the Treasury which was feature of the Building Societies Act.’

Some legal considerations of the recently enacted legislation. Work started on June 20 on a consolidating statute of the Building Societies Acts 1874-1960. Comments on how a number of items from the ‘Victorian’ 1874 Act are ‘... still with us, and in viable form’. The peaceful and non-litigious history of building societies has provided very little case law to help define statutes.

The post-war market boom made it ever more frequent for the CRFS to initiate enquiries responding to at least one of the following headings:

a) unsatisfactory financial position of the society as disclosed by its accounts;

b) lending of the society’s funds on doubtful security, and

c) the use of society’s funds for financing companies with which the society’s directors were connected.

Acknowledges the Building Society Association had been pressing for new legislation for some time but the Government was slow to respond (had it not been for the affairs of the State Building Society).

‘The Act has had to go some length to meet the difficulty [of lending too much to too few people] by creating the special advance on the one hand and by adding to the directors’ responsibilities the control and disclosure on the other. Ancillary protection is provided by stiffer accounting, auditing and investment standards and by giving the Registrar enlarged powers.’

The new Act might increase the minimum size at which a society can function independently. It might give new impetus to mergers.

Regarding comments and criticism that the Act brought more bureaucracy he said: ‘No honestly managed and competently administered building society should find it hard to comply with the new provisions, but any society which fails to do so may expect stern treatment. Because of this I feel sure the Act will serve to enhance our reputation... The old traditions of operating on a shoe-string are a reflection of the personal concerns for thrift felt by building society managers. We are shortly coming to a time, nevertheless, when societies which wish to serve the community by expansion and yet retain trustee
status must have wider margins.’

The four most salient aspects of the new Act are those dealing with rules, special advances, meetings and resolutions, and director’s duties.

Considers the administrative consequences of the new legislation under the headings: investment of surplus funds, guarantee fund, changing the Rules, and regulations. Regarding the latter, it is feared that the CRFS will be given power to control the administration of societies in many important aspect of its business. These rules had yet to be issued in detail.

In discussing the link between the national rate of savings and the House Purchase and Housing Act 1959, he considers that:

‘The Building Society Association can be proud of the part it has played in the formulation of recent legislation.’

During a presentation at the South-Eastern Association there was a lengthy discussion of section 14. Millican then invited debate on ‘several sections in the Act which so far he had not yet seen debated at any building society meeting.’ Namely section 21 (establishment of a guarantee fund); section 11 (investment of surplus funds); section 55 (payment of introductory commissions to directors).

It was known that the Building Society Association had considered amending legislation since 1958 but ‘Not until the Bill was very far advance in draft, was the Association aware that it was to assume such extensive proportions.’ Later on he states: ‘In framing this notes I have made no comment upon many sections and provisions, e.g., those relating to new societies, and many matters which are purely of accounting significance and which would be better interpreted by one of specially skilled in this field.’

Goes on to discuss the background of the Bill and how the CRFS dealt with problems, objects to section 14, penalties of non-compliance, introductory commissions, greater power of the Chief Registrar, market valuation of investment funds, surplus funds, liquidity ratios and the register of members.

‘The draftsmen of the Bill, no doubt receiving their brief from Government’s advisors, seem to have been determined that as far as possible the provisions of the Companies Acts should apply to building societies. It was not was not easy to convince the negotiations, or Parliament, that the operations of a building society were in many respects far removed from those of a limited liability company.’

‘Almost a third of the number of sections in the Act are devoted to accounts and audit, meetings and special resolutions and annual returns. Arising out of these provisions every building society will find it necessary to amend its rules. A period of fifteen months is allowed to do this.’

‘There are many directions in the Act addressed to auditors, specifying their duties. Their appointment and removal are fully dealt with.’

Source: Building Societies Gazette, vol. XCII (1960)
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Notes

1 Building societies are mutual organizations, which for much of their history specialised in liquidity creation by turning retail deposits into mortgage loans.
2 Accounting and auditing requirements for building societies dated to the Building Societies Act 1874, which required individual societies to specify the appointment of auditors and make audited financial statements available to members. In addition to these, the Building Societies Act 1894 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).
3 'Building Societies Bill', Building Societies Gazette (June, 1960: 452-3).
4 Regulation concerning building societies was subsequently re-grouped into the Building Societies Act 1962.
5 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).
6 Williamson (1989: 223-4), concerning corporatist mode of interest representation, states that ‘Corporatism 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’.
7 Murphy (1984: 548) also defines social closure as ‘the process of mobilizing power in order to enhance or defend a group’s share of rewards or resources’.
8 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.’
9 But, the growing market for accountancy labour promoted the formation of organizations for excluded practitioners. As at February 1930, at least 17 fragmented accounting bodies existed (Stacey, 1954: 138).
10 In reforming Building Societies Act, the Treasury and the CRFS took views from some interested groups including the ICAEW and the Building Societies Association (Registry of Friendly Societies, 1961: 14).
11 The importance of testing the effectiveness of internal control in conducting audit of accounts had been recognized in the early 20th 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”.

12 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.

13 The Treasury, in cooperation with the Bank of England, had advised the BoT on the extent to which the definition of ‘banking’ business was applied to individual cases (BT58/726; T233/2003). But this exemption was not the case of building societies, whose disclosure requirements were regulated by the Treasury through the CRFS.

14 P&L Committee Minutes Book G: 36.
15 P&L Committee Minutes Book G: 39.
16 P&L Committee Minutes Book G: 39.
17 P&L Committee Minutes Book G: 103.

18 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).

19 T&R Committee Minutes Book B: 216.
20 P&L Committee Minutes Book G: 125.
21 T233/1652.

22 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.

23 T&R Committee Minutes Book B: 216.
24 P&L Committee Minutes Book G: 141.

25 They were: G. G. G. Goult, A. Rayner and F. C. A. Ledsam (P&L Committee Minutes Book G: 141).

26 The Building Societies Acts, 1874-1940 prescribed Form A.R. 11 which summarised 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 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.).

28 P&L Committee Minutes Book G: 148; T&R Committee Minutes Book B: 231.
30 P&L Committee Minutes Book G: 165; T&R Committee Minutes Book B: 237.
31 P&L Committee Minutes Book G: 176.
32 P&L Committee Minutes Book H: 164.
33 P&L Committee Minutes Book I: 43.
34 P&L Committee Minutes Book H: 165.

35 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).

36 P&L Committee Minutes Book H: 172; T&R Committee Minutes Book C: 37.
37 T&R Committee Minutes Book C: 37.

38 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.

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


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.

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

P&L Committee Minutes Book I: 89. According to a private memorandum written by a councillor of the ICAEW and cited in Zeff (1972: 26), ‘Earlier the Council had made strong representations to the appropriate Government departments for a complete overhaul of the law relating to the accounts and audit of building societies, and having substantially achieved its objectives in the Building Societies Act, 1960, the Council felt obliged to issue a comprehensive statement of guidance’.

P&L Committee Minutes Book I: 90; T&R Committee Minutes Book C: 89.

Unless otherwise stated, this paragraph borrows freely from 'Building Societies Bill', *Building Societies Gazette* vol. XCII (June, 1960), pp. 452-3.


Comments were then put forward to the CRFS at interviews held on 17th June: 263; 24th August: 275.

T233/1652-Anonymous. Probably a communication between civil servants spearheading the Bill, namely from Mr. Vollmar at the Registrar of Friendly Societies to E. W. Maude at the Treasury. It could have well been prepared at the Treasury as part of the preparations for the meeting of 4 January 1960. Among other things, the tabular form summarizes memoranda from the Building Society Association or BSA [8 December 1959] and from the Halifax Building Society [19 December 1959], which at the time was not part of the BSA. The document dates to circa 2 January 1960).


The number of mortgage borrowers for the top five in terms of assets for fiscal year 1959 was: Halifax 394,457; Abbey National 230,052; Co-operative Permanent 171,302; Woolwich Equitable 118,347; Leeds Permanent 101,035 (Building Societies Association, 1960: 135, 163, 225, 318, 353).

According to Sir Bruce Whycherley, Managing Director of Abbey National, the proposed new Act might increase the minimum size at which a society can function independently and therefore give new impetus to mergers. Regarding comments and criticism that the Act would bring more bureaucracy he said: ‘No honestly managed and competently administered building society should find it hard to comply with the new provisions, but any society which fails to do so may expect stern treatment’ (*Building Societies Gazette*, November 1960: 900).

(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 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 he 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 (i) of the Ninth Schedule (Board of Trade, 1962: 168).